IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1145/4/8/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

10th March 2010

Before:

VIVIEN ROSE
(Chairman)

PROFESSOR ANDREW BAIN OBE
MICHAEL BLAIR QC

Sitting as a Tribunal in England and Wales

BETWEEN:

STAGECOACH GROUP PLC

Applicant

- v –

COMPETITION COMMISISON

Respondent

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HEARING DAY TWO

APPEARANCES

Mr. Rhodri Thompson QC and Mr. Christopher Brown (instructed by Maclay Murray & Spens) appeared for the Applicant.

Mr. David Unterhalter SC, Miss Kassie Smith and Mr. Ewan West (instructed by Treasury Solicitor) appeared for the Respondent.

THE CHAIRMAN: Yes, Mr. Unterhalter?

MR. UNTERHALTER: I had yesterday submitted in dealing with ground 1 that the Commission had properly fixed upon a counterfactual and engaged in the very kind of reasoning that is required for the purposes of assessing causation by means of counterfactual reasoning and that in doing so if one has regard to the actual reasoning that is used in the decision it is plain that is what is sought to be done was to fix upon an appropriate bench mark in making a probabilistic judgment about the future state of affairs in the relevant market absent the merger. I wanted briefly to expand on that submission in two ways before moving to ground 2.

The first is just to say something more about the 'failing firm' and the second is just to offer a few legal submissions on the proposition that this is an error of law, because that is how ground 1 is cast. Something was made of the proposition that the Commission did not really make a finding as to the 'failing firm'. We submit that there cannot be a proper construction of the decision that was come to because there was really, in thinking about the counterfactual in this case a binary choice to be made. Either one was going to select a counterfactual along the lines that Stagecoach had posited and submitted which was to suggest that in effect the assets of Preston would exit the market and consequently there would only ever have been one firm in the market, and consequently there was nothing offensive about the merger that was proposed; or, there was going to be a counterfactual in which those assets did not leave the market and then the question is: What would that future state of affairs look like in the market absent the merger?

The Commission, upon its own analysis and making a judgment as to what it considered to be normality, or conditions of normal rivalry in the market, constructed the counterfactual in the manner that we have already analysed. But the salient feature of that counterfactual is that, absent the merger, there would be two, and there would be rivalry between those two firms. For the purposes of the Commission's analysis that rivalry would approximate to the kind of rivalry that existed in 2007 and that is a judgment that it made as to what, on its own view looking forward, would be the most likely structure that emerged from the market. But it matters little ultimately whether one thinks of that as right or not, because from the point of view of a legal challenge the only question is: was that a permissible form of counterfactual reasoning and once there are going to be two in the market absent the merger, the result of this merger is really very, very straightforward because it was to create a monopoly in circumstances where, absent the merger, there would not be one and it hardly requires much to say then that this merger stood to be condemned.

We do submit that in the entire structure of reasoning Stagecoach having posited the failing firm that had to be rejected and was rejected and it is that reasoning which is captured in para. 6.4 of the decision, and I shall not go back to that passage, but it is perfectly plain it was rejected, and consequently if one then reads on in then thinking about the competition that then would have occurred absent the merger, it is entirely predicated upon the fact that there would not have been a failing firm position even had the merger not gone ahead.
That is our first submission in expansion of why it is that this counterfactual was both indicated and an entirely lawful form of reasoning in trying to assess this merger.
It is also important in our submission that that reasoning is situated within the structure of the relevant market because a good deal of the reasoning offered by Stagecoach on this score would seek to, as it were, divorce causal reasoning from the economic context in which such causal reasoning has to take place. In this context it is perfectly clear that in making the assessment of the counterfactual one has to engage in the market as one assesses it, and that is a mixture of things; it is made up of a number of components. So for our learned friends that must be a slice of time, you have to examine the market at a particular point and no other, and that for them captures what is at stake at any course of inquiry. We submit that not only under the provisions of s.35(1), but also under the Guidelines, that cannot possibly be the case. One has to examine a market and its structure and the dynamics of that market, because markets have histories, they have contingencies, and some of them may change quickly and some of them may change slowly, but in any event what makes up the market, and how one makes a prognostication as to what the market will do absent the merger cannot be an impoverished analysis which says we will take a single point in time and simply look at anything we find in the market at that point and say that is the only permissible proxy for what a market will look like in due course. That is then the fact that that proposition is unsustainable is given full expression to in the Guidelines, where it is made plain you can and must, if the circumstances require, consider what features in the market may be of only a temporary relevance, and which features are enduring, and therefore which are the best guide to what is likely to happen.
There are a number of components to that and some of them seem to be entirely common ground between the parties. So, for example, both in the Guidelines and in the skeletons exchanged between the parties, it is entirely accepted that if there are anti-competitive conditions that have arisen in the market that arise by reason, for example, of price fixing or market sharing arrangements that have been engaged between the very parties to the merger, one would not have regard to those conditions to say: "Competitive conditions in

this market are very suppressed anyway, and therefore the merger is unproblematic", that would plainly be an impermissible form of reasoning. Therefore, which ever way one looks at the problem it is necessary to have a proper economic assessment of the market with all its features, dynamic and not simply static, in order to determine what is the best proxy, and that is an example.

Our learned friend suggested that that is somehow a special exception. We submit it is not a special exception at all.

THE CHAIRMAN: I think what is at issue is whether you only discount things as being likely to move forward if there is something not quite right about them, it is a value judgment that they are somehow improper that then causes you to discount them from the counterfactual, but I think what you are saying is it is not limited t o that kind of thing, there is no pejorative aspect to saying: "We are not going to treat this as what is going to be the future position"?

MR. UNTERHALTER: With respect, we would entirely agree with that proposition, which is to say sometimes the relevant features of the market may have to do with anti-competitive practices which would be unlawful, but those are not the only features that might be relevant to making the future looking judgment, and so in this case the dynamic features of the market which were thought to be of critical relevance were the ones that dealt with why it was that the form of competition which was observed in the 18 month period before the merger were simply unsustainable.

One can take a view and we shall come to the factual foundations of that construction, but it is a perfectly permissible view to take, that what you see in 18 months is not a good guide to the future. Hence, it is permissible, it is not excluded by law, indeed it is a very proper way of trying to understand a market as a dynamic structure and not simply in the static time slice which appears to be the way in which Stagecoach would conceive of the exercise.

One can generate numerous examples of this, but just to give one further and last example to show why markets must be understood dynamically, if there were for example a wholly temporary ban on import for some reason and two firms were the only two domestic producers in the market who then wanted to merge, one would not necessarily say that that merger would be condemned if, in ordinary conditions of competition, there was substantial substitution that ensured that there was a high level of competition in the market. It would be an irrational way of approaching the counterfactual.

I do not need to generate any more abstract examples, that is why both in the guidelines and for the purposes of any common sense reasoning around a counterfactual, one cannot simply list the only permissible factors that will go into the proper construction in making a forward looking and necessarily probabilistic assessment of what is likely to occur absent the merger.

That was the first submission by way of situating the argument under ground one.

The second is just to come back to the authorities. Again I do not want to belabour this point because they have already been traversed in substantial form, but I did want to just revert, if I may, to the *BSkyB* decision which appears in the authorities bundle at tab 2.

Could I direct my submissions firstly to para.85 where the nature of the SLC test is addressed:

> "The SLC test in the Act requires an assessment of the effects of a merger on the state of competition in a relevant market. In assessing the likely effects of a merger on competition, the Commission, as in the present case, typically compares the situation that may be expected to arise following the merger with that which would have prevailed without the merger."

Then reference is made to the guidelines.

> "The market situation without the merger is often referred to as the 'counterfactual'. The counterfactual provides a useful benchmark against which the existence or otherwise of SLC can be judged."

I would just pause to remark that it is the utility of the counterfactual as a device, not the legally obligatory qualities that the construction of the counterfactual must have in order to show fidelity to s.35. Therefore, the court situates the test exactly for what it is, which is of utility for the causal exercise that is contemplated.

I am asked to read on, so para. 86:

> "The Commission indicated that in order to consider the effect of the Acquisition on competition and plurality it compared:
>
> 'the situation that we expect to arise following the acquisition to that which would be expected to prevail had the acquisition not occurred (the counterfactual).'"

Could I then refer to para. 91. There were certain submissions made, again in this case, concerning how the counterfactual should be considered and adopted, and in dealing with these submissions the following was said:

> "We do not agree with Sky's arguments. The identification of a counterfactual does not mean that possible changes in the market cannot be considered in the assessment of SLC."

Exactly the submission I have just been making.

> "The identification of the counterfactual does not ossify the SLC analysis. Indeed Mr. Flynn QC, who also appeared for Sky, rightly accepted that the counterfactual could not be 'pinned to a board like a butterfly at an early part of the Commission's assessment, it actually remains alive, vibrant and important throughout' the substantive analysis. As already noted, the purpose of the counterfactual is to assist in assessing the effects of the merger. However, it must be kept in mind that counterfactual is not a statutory test ..."

Just pausing there for a moment, the foundation of ground one is to suggest that the counterfactual is a statutory test, that somehow in constructing the counterfactual as the Commission did in this case, it erred, as a matter of law, in that it offended against the requirements of s.35. This is authority to the contrary. It suggests, carrying on with the citation:

> "... it is an analytical tool used to assist in answering the question posed by section 47 of the Act ..."

– here 35 –

> "... namely whether the creation of an remembers may be expected to result in an SLC ..."

So we do submit that as a matter of law the counterfactual and the way in which it is constructed simply does not give rise to the sort of challenge that has been made under ground one.

We have in our skeleton dealt with the guidelines, and again I do not wish to belabour these points either, they appear at paras.57 and thereafter in our skeleton. The fact is that the guidelines in any of the versions set out here allow fully for ----

THE CHAIRMAN: I think Mr. Thompson took us to the guidelines.

MR. UNTERHALTER: It is quite clear that they allow for flexibility very much along the lines that I have suggested and which was utilised, we would say entirely properly, for the purpose of engaging in the causal exercise. We, therefore, submit on ground one that this is not a proper challenge and it should be dismissed.

MR. BLAIR: Can I just ask you a question on your "failing firm" point, an attractive proposition, but how does it cope with the fact that a failing firm's assets could then be transferred to a new third party incomer? How far does that proposition undermine your argument?

MR. UNTERHALTER: In our submission, that would no doubt have been an available possibility to the Commission in constructing a counterfactual. One possibility would have been for the Commission to say, "We concede that these assets would actually vest in other hands", and consequently the most likely outcome, absent the merger would be these assets, Preston's assets, now in the hands of another, perhaps a national, company with greater resources. That might have been one way of constructing matters.

It would have given rise to a very similar result to the one that was achieved here.

MR. BLAIR: Yes, it would still be two firms and two assets but still a failing firm.

MR. UNTERHALTER: It might well have been a failing firm then on the assessment of the evidence, but not a failing firm for the purposes of the defence – it is not a true defence – but certainly for the purposes of the submission that Stagecoach made. For their submission to have succeeded, the assets would have had to leave the market substantially.

THE CHAIRMAN: They had to either leave the market or they had to be acquired by Stagecoach.

MR. UNTERHALTER: Yes, indeed. The reason that Stagecoach advanced the proposition that the merger was not problematic was because those assets were destined to exit the market anyway. So under the counterfactual without the merger those assets would not be there to constrain Stagecoach in any event. Therefore, the merger made very little difference to the competitive rivalry in the market. That is the logic.

THE CHAIRMAN: What you are saying is that it was not enough for them to just argue that PBL would have failed, they have to show that it would have failed and that it would not have been picked up by somebody else who would then be a second player in the market.

MR. UNTERHALTER: Indeed, and our submission on that score is, ultimately, because of the review standard which governs these proceedings, it is not really available for Stagecoach to argue that a better counterfactual that would have generated an outcome still involving two firms was one that the Commission should have engaged in because that is not, we would submit, a proper basis for challenge. One has got to show that the counterfactual that was adopted was either done so by way of error of law, which I have dealt with; alternatively, that there was no evidence that could conceivably have supported the counterfactual that was adopted. So, there is no challenge here to the notion that there is somehow an irrational counterfactual. The challenge is very simply that either it is an error of law or the evidence does not support it. Under a standard of review, that is to say that the conclusion reached was simply not one that could reasonably be reached by a reasonable decision-maker. Stagecoach has got to live with the kind of challenge that it has brought.

Simply to return to -- Assuming we were not in the world of review, and we were simply asking what were the available counterfactuals, certainly that was one that might have been adopted. It was not. But, it could perhaps have been.

If I might then proceed to Ground 2? There is a great welter of detail that has been advanced by Stagecoach. I certainly do not intend to cover every one of the small points of detail, much of which we have traversed in the Annexe. What I did want to do though was to take what seemed to be the central propositions that are now being advanced under Ground 2 and examine them.

But, before doing so, I wanted to make two initial submissions. The first is simply to go back to what the relevant standard of review is in engaging this inquiry. It is such an enormous temptation if one starts to delve into the facts to start reasoning around, "Well, would I have come to that conclusion?" As all the authorities make plain - and there is no difference between us on this score - correctness is not the standard. So, it really does not matter whether I believe that the Commission might have come to a different view on those facts and drawn different inferences. The simple question is to determine whether no reasonable decision-maker could have reached the conclusion that the Commission did.

There is a supplementary feature to that standard of review which is that materiality counts in engaging and thinking about the reasoning and the inferences that were drawn by the Commission. Quite a bit of the challenge that is made here is done on an atomised basis, which is to take a number of different points, and then say, "We think this is wrong ... we think this is wrong ... we think this is wrong" and somehow to suggest that on a collective view of point-taking there is a collapse of the decision. We submit that is simply not the correct approach. What one has to do is to see what the evidence was; see what conclusions were reached; and then try and determine whether the review standard is met which is to say: must a reasonable decision-maker have come to a wholly different view from the one that was actually arrived at, and that that was the only view that could have been arrived at? That is a very challenging standard.

THE CHAIRMAN: Is that right? If it were to be the case that, say, for a particular finding, which it is accepted was an important finding, there were five building blocks, as it were, on which the Commission relied, certainly if we were to find that two of those building blocks had no foundation (if I am not mixing metaphors), but three of them did stand up, then I can see that that might well not reach the threshold for review. But, if we were to decide that all five of them were actually without substance, so that there was actually nothing supporting that finding, would it not then be that we might need to quash the decision and send it back for them to re-do that part? Or, are you saying that, no, we still have to look ourselves at whether the conclusion that was drawn - albeit now *ex hypothesi* on the basis of no evidence - still might have been the correct conclusion?

MR. UNTERHALTER: No. We certainly would not submit that that was the case. There are, in our submission, two slightly different aspects to the inquiry. One is materiality, which is to ask, “Upon what foundations does the conclusion rest?” If there are independent foundations for the conclusion, then merely to knock out one strut does not cause the building to collapse. One has to make that assessment. Indeed, one of the features of Stagecoach’s challenge is that it never really makes that assessment. It does not really say, “Fundamental to the conclusion were the following five propositions. The decision must stand or fall because if one of those is bad, then the whole structure fails”. One never has the sense that they have really assessed the structure of the argument as a whole to determine that point. It is simply that a number of things are said to be wrong, and that consequently it is said that the decision should be quashed. We submit that that is not the correct approach. That deals with the materiality principle.

The related, but somewhat separate, inquiry is to say, “Well, given the findings of fact that were made, can it be said that no reasonable decision-maker could reach the conclusions that were derived from those findings of fact?” So, it is not whether they were wrong, but really whether the process of reasoning from the facts found to the conclusions reached is simply so irrational as to not permit those conclusions to stand.

THE CHAIRMAN: But is there not also the stage that if we were to decide that actually the facts found were not properly based on evidence that was before the Commission and that no reasonable Commission would have found those facts on the basis of what was in front of them, then that must be the basis of a successful challenge without us then having to consider the next step of what inferences are properly drawn from those facts. There is a ground of judicial review which would say, “You can look at whether there was evidence to support the findings of fact - not just the inferences drawn from findings of fact”.

MR. UNTERHALTER: We, again, would entirely concur, with respect, with that proposition. The point, though, is that from the evidence one again has to apply the standard of review which is not to ask whether I think that those findings are correct - but, again, whether a reasonable decision-maker could reach those findings on the basis of the evidence that was before it. There is always in this scheme of things an enormously difficult line to tread between standards because one naturally, when engaging the facts, tends to think about why that evidence either does or does not give rise to a particular conclusion. It is simply a discipline for the purposes of this review which requires that one considers the various kinds of inferences that can be drawn from the evidence that was admitted, and there is a large measure of appreciation that must be permitted. So, it is fundamentally an irrationality standard. One has to say, “No-one could conceivably find that fact or draw that conclusion from that fact because to do so would be irrational or perverse”. We only make that submission because, as we now delve into the facts, it is - and I am sure I will fall into the error myself of making submissions which would seem to suggest correctness rather than rationality - rationality that really founds the basis of the review.

There are, in our submission, perhaps two fundamental points that Ground 2 rests upon. The first is the debate around what were Stagecoach’s reasons for entry. The second is what were the effects of that entry, quite apart from the reasons. We do submit that, again, this debate needs to be situated within the scheme of the reasoning that is actually adopted by the Commission, because the second of those inquiries is the one that really matters for the purposes of the Commission’s reasoning. There is a lengthy treatment of the reasons for entry. But, nevertheless, the approach that the Commission takes in the end is to say, “We will not conclude one way or another why Stagecoach entered because we are not certain we can be absolutely definitive on that point. What we are certain about is that the effects of its entry were to marginalise Preston and that the kind of competition that followed in that process was not sustainable. It is really that second proposition that is fundamental to the scheme of the argument, and this is where the materiality test really matters because at the heart of the decision that the 18 month period is not indicative for counterfactual purposes, and therefore the critical inquiry for the Commission is to determine whether this is unsustainable competition in the 18 month period. That proposition in turn rests very substantially upon a body of evidence which, amongst other things, shows that the parties themselves did not consider it to be sustainable competition. So although one can delve deeply and we can cover some of the ground that deals with the reasons for entry, the reasons for entry are somewhat probative of the question as to whether the effects that were ultimately found were ultimately possible or probable, but they are not definitive in any way of the ultimate question as to what the effects of entry were, and whether or not they were unsustainable.

PROFESSOR BAIN: Sorry, could I just interrupt you. You were saying the effects were unsustainable, and I thought you were saying earlier on that the nature of the competition in the 18 months was unsustainable, which I thought was common ground. I do not what the phrase, “the effects were unsustainable” means?

MR. UNTERHALTER: I may have used a loose formulation, what I was intending to convey is that the assessment that was made of the entry was that it generated competition that was unsustainable, that is a proposition that is fundamental to the view that the Commission takes of the matter, and it is said of the entry that it had certain predictable effects, or rather that its effects were to marginalise PBL. So this is not a question of intention; it is not a question of ultimately what were the objectives of Stagecoach? They are considered and they are somewhat probative of the ultimate conclusions but they do not rest upon coming to any definitive view on that score. The critical question is having entered in the form that they did it had certain effects, and the effects that it had in the market were to render PBL unsustainable – I am sorry, I am now again mixing this up – it significantly weakened PBL in the market, that was the effect that was felt, but through a form of competitive engagement which was unsustainable, and that is the critical point.

PROFESSOR BAIN: It is the use of this word "unsustainable". I think everybody agrees that this is not a normal feature of competition in a generally stable market. Is it unsustainable to compete in that way as a means of gaining market share. One of our difficulties that we have in this is that we look at the problem of gaining a significant element of market share from an incumbent with a very high share of the market. Is it illegitimate to try to get that market share? Is that uncompetitive, or not normal competition? Normal competition, I think we would have thought, was that it was perfectly legitimate to try to increase your market share. Then the issue comes down to: how do you do it? There may be different ways of you attempting to do it and many of you may have different views about those ways. But actually trying to increase market share is not illegitimate, and unless you can demonstrate that intense competition of the kind that appears here was illegitimate, we have difficulty in understanding why you treat that as abnormal competition. It looks to us, I think, in some ways as if it was really quite normal competition given the objective which was a legitimate objective.

MR. UNTERHALTER: Well we would draw a number of distinctions in answer to that proposition, which is the question of legitimacy suggests and it has been suggested that we are somehow wanting to engage in a question around legality, which is not the issue at all that the Commission was concerned to determine. What it wanted to know, which was whether the form of intervention in the market that took place, would measure up against some norm of ordinary profit maximising behaviour of the firm and that is the real criterion for determining whether this is normal, or abnormal – or, to put it more neutrally, atypical competition.

In our submission the Commission's view of this was not to determine it by what were the objectives? Was it in fact to secure 25 per cent of the market, or some market share, or ultimately to decimate PBL, but simply to analyse what form did this entry take, against what market circumstances, and with what consequences, and then to ask whether that is typical of what one would expect from a rational profit maximising firm? The answer that was derived was "no", that it was not, and for a number of important reasons that I will come to. Perhaps, as it is fundamental to the structure of reasoning, just to foreshadow what I mean to address, the structure of the market *ex ante* in 2007 is one in which it is, as I indicated yesterday, a market for commercial bus services in the Preston area, in which there had been essentially a division between the intra-urban segment, and the inter-urban segment, and that was a division within the market and not between markets.

Fundamental to the structure of the market as it existed prior to Stagecoach's intervention in 2007 was that the Commission found, and this has not been challenged, that there were significant competitive interactions between Stagecoach and Preston, both as to actual and potential competition. So that was, as it were, the equilibrium that existed in 2007. The Commission does not suggest that any change to the equilibrium must be abnormal, although it was a highly durable equilibrium that had existed, and one reads in the evidence, for example, that year after year Stagecoach had considered whether to buy, or attempt to buy, Preston, or enter the market and year after year they had concluded that it was preferable to try and buy it rather than enter on to the intra-urban segment of the market. That was the equilibrium.

Then the question is: when we assess what is actually done against that equilibrium, how do we judge the behaviour of the firm? Is it profit maximising behaviour that is engaged in, or is it something highly atypical of what one would expect in a normally functioning market.

THE CHAIRMAN: So the reason why you are having to assess that is really twofold, is it not? The first is to decide whether the 'failing firm' defence is correct because actually this market is only big enough for one person.

MR. UNTERHALTER: Yes.

THE CHAIRMAN: And you reject that. But the second reason why you have to look at this is to decide what is going to be included in the divestiture remedy; whether the divestiture remedy has in effect to try and reinstate what you describe now as the equilibrium that had existed for a long time, or whether you would say: "No, it does not need to do that, because actually what happened in the run up to the merger was intense competition" – there is nothing unlawful about it, it might be thought that that is what competition is supposed to be about. We do not think it would have continued in a sense of completely resulting in a monopoly, but the shares of the intra-urban business at the date of the merger were sustainable, but perhaps not a greater share of that was sustainable. That is, at the moment, the difficulty that I see, that there is nothing in the decision that indicates that the Commission thought about what share of the intra-urban market sector should be attributed in an ongoing fashion to Stagecoach for the purpose of determining what the divestiture package should be.

PROFESSOR BAIN: Could I just try to develop it a little here. The Commission has decided that there is room for two firms. The Commission has not, I think, decided that it must be the case that one firm has 90 per cent market and the other 10 per cent, of the intra-urban segment of the market. I do not think they decided that. We have not seen that decision. As far as I could see, it was quite compatible with the Commission's view that there could be two firms in the market for one firm, A, to have 30 per cent of the market, and the other firm, B, to have 70 per cent of the market. It might be that PBL could not survive on 70 per cent but perhaps Arriva could. The Commission's conclusion on this, so far as I see it, is that you can have two firms without any clear view about the precise market shares, or even the broad market shares of the two firms. Two could continue to exist in the market and that, as I see it, was the evidence that you were given. Both sides were saying, yes, there is room for two firms. It makes a big difference to the counterfactual whether you say, "We are going to insist on it being 90/10 as the starting point", or whether you are going to say, "In the light of the circumstances that existed at the time of the merger and in the light of the objectives that Stagecoach had stated to be their objectives, 70/30 was much more likely to arise", and so that should be the counterfactual. That is the difficulty that we have at the moment, as I see it.

THE CHAIRMAN: Yes, and I think you can for the question of whether you prohibit the merger or not it does not matter, you are still talking two to one and therefore it is still a substantial lessening of competition. For the purposes of the remedy that seems to us to be a plank or an investigation that does not seem to have been gone through by the Commission. I hope that explains it.

MR. UNTERHALTER: Perhaps I can try and answer the various questions that are posed in putting the proposition. In essence, what is, I think, being put to me is that what the Commission should have done is to consider that if there are to be two there might be a set of market shares that were rather different from the equilibrium that I have described because something should be attributed to Stagecoach's entering into the intra-urban market.

PROFESSOR BAIN: I can put it slightly differently. The 2007 position was one equilibrium. There are other possible equilibriums in which Stagecoach could have had a larger share.

MR. UNTERHALTER: As to that, it depends upon how the Commission sought to understand the 18 month period as evidence of whether something about what occurred in that period is, or should have been taken to be demonstrative of a durable share for Stagecoach going forward or not.

Again, if this were a correctness standard, if it were the case that we were being asked, "On the probabilities, if I were making that decision, is that something I might have wanted to explore?" Possibly. But that is not the issue, with the greatest respect, that the Tribunal has to determine. What the Commission did was to say, "I consider the 18 months in its totality to be atypical competition", and consequently any share that is derived through that process is not a good proxy for the future state of affairs absent the merger. That is the reasoning that they adopted.

So unless that reasoning is wholly irrational, and with respect we cannot see why it is irrational, as has been pointed out to me, there are various possible equilibria that could develop in a market, and when one is trying to assess future states of affairs in markets if that were a perfect science then everybody would be either enormously wealthy or no one would ever be able to make any money in any market. But, the question of prediction in markets as to what would be the correct equilibrium is precisely the judgment of the Commission's to make, and it has made it not on an implausible irrational premise and not on implausible or irrational evidence. The critical feature is, how does one characterise the 18 month period? If it is atypical and no growth or gain in market share over that period is attributed on a forward looking basis, then the decision must stand.

I am sorry, I wanted to just answer about the remedy. Just as to the question of what that means for the remedy and whether the remedy would be too aggressive because, conceivably what is happening is that one is, as it were, not giving Stagecoach its due, we submit that understood in the remedial context the purpose, and I shall come to this, of the remedy is not to try and restore the equilibrium in its identical form as it existed in 2007, but to ensure that there are enough assets that are saleable to an entrant into that market that would offer sustainable competition against Stagecoach. That is the criteria. So the criterion is not, "We are trying to ensure that we can restore the equilibrium exactly as it was, configured identically to the distribution of assets as they existed", because for various reasons that is not going to happen.

I could perhaps just refer you, whilst we are on this subject, to para.10.22 of the decision where that proposition is raised:

> "In making our assessment, we sought to identify the smallest, potentially viable, stand-alone business that could compete successfully on an ongoing basis and that would effectively remedy the SLC. Such a unit would need to include at least PBL's depot and the operator's licence without which the new owner of PBL could not operate commercial services within Preston."

Then if one wants to see how the Commission decided on its ----

THE CHAIRMAN: Let us come to that a bit later. I see that what you are saying is that, yes, you did decide, because of how you characterise the 18 months of competition, that none of the market share that Stagecoach had won over that time should necessarily be reflected in the ongoing counterfactual, because you made a clear finding that they would not have entered the intra-bus sector if they had not intended, or thought that they were going to be able to acquire the whole of PBL.

MR. UNTERHALTER: Perhaps I should put it more simply, it has less to do with what they intended or aimed at, but rather that what they acquired, whatever that percentage was, was acquired in circumstances where they were making significant losses. So, it was significantly unprofitable entry into the market. I am going to come to how that is constructed.

THE CHAIRMAN: Yes. But, then you say, "Well, even if that was the finding, it might not have affected the remedy because in any event, with the remedy we were always looking not to turn the clock back to 2007, but just to put together the smallest viable package". We will have to come back to that.

MR. UNTERHALTER: We shall come to that. I had intended to deal firstly with the question of the reasons for entry and some of the evidence that deals with it.

THE CHAIRMAN: Take it in the order that you want to take it. Do not let us disrupt your line of reasoning.

MR. UNTERHALTER: It may be helpful though, given that this is perhaps a key question - which is whether it was rational for the Commission not to attribute any of the gain in market share that Stagecoach had achieved in the course of the eighteen months for the purposes of constructing the counterfactual - perhaps I should deal with the profitability issue because it arises directly. The key proposition for the Commission is the proposition that the entry that had been engaged upon by Stagecoach was simply not profitable and, in fact, was deeply loss-making. It is to be recalled that part of the reason that was offered for the entry that took place was to say that the Preston bus depot had not been performing sufficiently. So, the notion was that this entry would somehow assist in restoring the profitability of the Preston depot. That was part of the evidence that [Stagecoach Director] gave on that score.

One therefore has to see what did happen by way of the entry and the assessment that is made by the Commission on this point? That part of the decision is reflected at para. 5.23 on p.22 of the Decision. Picking up that paragraph, it says, “In 2007 Stagecoach’s Preston depot generated an operating margin [...]”. But one sees that it was actually a profitable depot.

> “The profitability of the depot worsened significantly from June 2007 and it made an operating loss in both 2008 and 2009. Although it was clear that its new services were initially loss-making, Stagecoach told us that at the time of the merger, the new services which had then been operating for eighteen months were breaking even. This was based on an incremental cost allegation methodology developed specifically for the Project Biscuit [Project Biscuit being the name given to the entry by Stagecoach into the intra-urban services] rather than the full cost allocation methodology normally used across all of Stagecoach’s depots to assess the performance of established routes. Stagecoach told us that in launching the new service it aimed to improve the profitability of its Preston depot, which suggested to us that it was planning to operate these services on an ongoing basis”.

In other words, from the Commission’s perspective if you were trying to improve the profitability of the depot, this is not a short-run strategic intervention in the market - you are trying to ensure that your depot and the costs attached to that are turned to better account.

> “We therefore examined the profitability of the new routes using both incremental costing (used by Stagecoach to monitor the performance of its new services) and the normal cost allocation methodology used by Stagecoach to monitor the performance of all routes across its UK depots. The detail of this analysis is presented in Appendix G, paras. 21 to 46”.

Perhaps I could then ask you to turn to that appendix? Forgive me, if you will, for belabouring some of the detail in this appendix, but it matters to this question around what Stagecoach was doing and what its intervention really meant.

At para. 16 there is a discussion about profitability against various benchmarks. There is a consideration of certain benchmarks which were suggested by Stagecoach itself. Those are dealt with at paras. 16 and 17. In particular, one sees reflected in Annexe 3, which is in G23, that there is in para. 3 of Annexe 3 a recitation of what Stagecoach said concerning relevant benchmarks. In para. 3 of Annexe 3, which is at G23,

> "We discussed with Stagecoach the budgeting of these new routes and expectations of management with regard to likely timescales for profitability. Stagecoach stated that there was not a profit or loss forecast; simply a cost projection with regard to introducing the new services in Preston during 2007/2008".

If I might pause there for a moment -- One of the factors that the Commission thought was most unusual was a situation where you are trying to improve the profitability of your Preston depot, and the only estimate that you make is as to your costs. You make no revenue projections whatsoever. You do not determine where you are likely to break even; when you are likely to break even; what sort of margins you may secure; are you meeting your internal hurdle rate, or not? Nothing is done on this score. However, that is what they are told Stagecoach did.

Reading on, Then there is the quoted bit.

> "However, in this case Stagecoach commented that, 'We did not project any revenue because it would simply be a projection ----'"

Again, what one pauses for a moment to ask is: In any business one makes revenue projections, but to say, "We are not going to do it because it is simply a projection - and again I would submit it is a rather unusual proposition to advance.

> "It could be almost any number. In terms of time to expected profitability Stagecoach noted that they would expect some sort of return at that level of time period [and then there is a period indicated] for an individual route. It is also said that it did not have a fixed timeframe in mind for positive contribution at an operating profit level, but thought that it would take an extended number of months, possibly to a year or beyond".

So, in terms of Stagecoach's own account of the relevant benchmark for profitability and the kind of timescale that is involved, the indication, if anything, is one within the one year period to turn profitable. It is done, though, simply on the basis with no revenue projections in mind at all. So, these are some of the starting points to try and assess, "Is this intervention a normal intervention by a profit maximising firm that is trying to improve the bottom line in respect of its Preston depot, or is it something else?"

PROFESSOR BAIN: Mr. Unterhalter, did Stagecoach ever say they were trying to improve the bottom line in the short term by doing this? It did seem to me, reading [Stagecoach Director]'s evidence at the July 17th meeting that he had very much the long term frame in mind, £[X] a bus in the long term, and was looking at this as an investment. He did say it would cost him a lot less than £[X] to do it. If you look at this as an investment you will inevitably have short term losses.

It is also, is it not, the case that in relation to the evidence that we looked at In Camera yesterday, which I cannot talk about too much, but the idea that you might take losses for a bit in order to gain profits later on was not one that was alien to the other companies?

MR. UNTERHALTER: Might I deal with the question as to what [Stagecoach Director] said concerning the rule of thumb, if you would bear with me for a moment I just want to get that portion of the record. It is under tab 11in the exhibits to the defence.

THE CHAIRMAN: Page 40, I think.

MR. UNTERHALTER: Yes, the record jumps around to various topics at different times as one perhaps expects, but one sees if you first have regard to p.29 when this issue of the time frame is discussed – or perhaps just to go back one step to p.27 just to see how these matters are dealt with.

The first issue was the curiosity that there is no consideration of revenue projections whatsoever, and at p.27 line 12 the question is asked:

> "Q. What do you normally mean as profit margin? Some difference between revenue and costs obviously, but what do you mean?
>
> A. (<u>[Stagecoach Director]</u>) The margin is just the operating profit over the turnover on the management accounts."

Then the question is put:

> "Q. So, think what we are struggling with a little bit in this area is we have gone through the various documents and we found a plan, a business plan, 4 August by Rob Jones for the new city network service. It is dated 4 August. One thing that does jump out at you is this business plan only really talks about costs. It does not talk about profit margins, it does not talk about revenues. It just talks about costs. So, you have told us you are focusing on the introduction of new buses into markets just generally to look at profit margins. Here, the only business plan we can find for the introduction of a service appears to involve an estimation of costs with no evaluation of revenues. Is that normal practice?
>
> A. (<u>[Stagecoach Director]</u>) Normal practice, as we have said, is that we do not actually produce business plans in the sense that you would all understand and I would understand in financial terms. The August figures were following the meeting with [Former PBL Director X]… I think I asked [Stagecoach Director], I cannot remember precisely, for some rough and ready ideas of what it would take to

> introduce a credible level of competition. No, we did not project any revenue because it would simply be a projection. It could be almost nay number."

Now it is for that reason in the first place that the Commission says: "You are making a significant investment of over £[X] in new buses, and you are simply saying: 'It could be any number, I have no idea what revenue I am going to generate from this investment'." In the Commission's assessment that is simply a first comfort of the fact that what is going on here is not ordinary profit maximising behaviour by a firm.

The next issue which is dealt with on p.29 of the record is this question around time. Here the questions are asked and picking up the discussion at line 9:

> "Q. In terms of the new routes you have introduced into Preston, what kind of time horizon did you have in mind for profitability?"

There is then a discussion about this, but picking it up more or less around line 15:

> "There were other operators in the area. We were establishing a marketing and promotional campaign which would obviously have an impact. So there were a number, if you like, of new variable factors that needed to be taken into account. It would be longer, possibly significantly longer, than start up time for an individual route. We estimated it would take longer than six to nine months that you have mentioned.
>
> Q. How long do you estimate it would take?
>
> A. ([Stagecoach Director]) I think we were looking at an extended number of months, possibly to a year or beyond."

So there is a vague assessment of time along that sort of trajectory. Then, somewhat later in the questions that are asked, there was then an issue around how do you do the calculations, and how do they get to the 25, and that is possibly best taken up at p.37 of the record. One issue that had arisen was: why did you need to put in all of these buses in such a short period of time, over all of these routes with such high frequencies and intensity, and the question was asked – just to pick up the end of that – at lines 6 and 7:

> "Why would you take the 'go for it' route rather than the 'build it' route?"
>
> A. ([Stagecoach Director]) I guess that is just the nature of our business. You are quite right, there was no strategic urgency. But once we had made the decision we would seek some share of that market, we would seek the share: almost, 'Let us get on and do it.' No particular rationale behind why do it all in one go rather than dribbles: probably more effective in one go."

And then the issue is raised about entry, and the question is asked at line 23:

"Have you any idea about what market share you wanted?"

A. ([Stagecoach Director]) In truth, no."

So his first response is: "no, I don't actually know." Then he goes on to say:

"What would I have settled for? I think if eventually we had established the 25 buses we originally put in, I was comfortable with that as a reasonable number. I would not have expected it to be any more than that. I might have even settled for a bit less at the end of the day, not much, there or thereabouts. I guess my rationale was that Preston Bus were an operator running about 100 vehicles, with a fleet of 120-odd, 130. A quarter of that would be a respectable share.

Q. If those 25 buses did turn out to be profitable, what kind of net present value would the provision of those services have? Any thoughts?

A. ([Stagecoach Director]) We did not do ---"

THE CHAIRMAN: That is [Stagecoach Director].

MR. UNTERHALTER: That is [Stagecoach Director] who says:

"We did not do any calculations. I have tried when we were doing the vehicle list to do net present values and so on, and I have always been told there is m ore art than science in these things."

So again, this question around the market share, we have an entrant that makes a very significant entry, makes a very significant investment, makes no revenue projections, has no idea what sort of market share they actually want to target and simply makes no determination as to what profits they might generate from the exercise.

PROFESSOR BAIN: With respect, Mr. Unterhalter, can you explain why [Stagecoach Director] needed to have a market share in mind, rather than know that he wanted to get an appropriate amount of business for 25 buses?

MR. UNTERHALTER: For this reason, that it seems basic to any entry which involves a significant investment that one must ultimately be looking to a return on that investment, and there has to be an internal hurdle rate of some kind that a firm has and, indeed, I am going to come to that point in a moment in the record. But it cannot be rational for a firm to say: "I am going to spend over £[X]. I am going to come into a market with that kind of investment, I have no idea what revenues I am going to generate. I have no idea when it is going to become profitable – if it becomes profitable, and I am allegedly doing all of these things in order to shore up the profitability of my depot."

THE CHAIRMAN: Could you articulate then – I know you say this is only one part of the evidence – what inference the Commission drew from what you say is the unusualness of that situation?

MR. UNTERHALTER: Ultimately what the Commission believe happened here was that this kind of behaviour was much more likely to be around marginalising the competitive position of PBL, rather than these vague notions about getting some market share, whatever it was, however big, no matter, against some time profile which is not determined as to when it would turn profitable.

THE CHAIRMAN: The marginalising PBL and therefore acquiring a much higher proportion, if not the whole of the intra-urban bus business.

MR. UNTERHALTER: One of the things that is said by the Commission on that score is that it would make PBL a much less attractive takeover target for a third party. That is one of the things that is done in consequence of decimating the opposition in this way. This is a zero sum gain. If you are suffering considerable financial detriment then by dropping prices in the way that it was done here, and we will come to what the price staging shows, then clearly you must be inflicting some very substantial measure of equal detriment upon your competitor in this kind of market.

The critical point – because this is just part of the evidence that is assessed by the Commission for saying "This is abnormal", it is the only part of it – is that it says, "When we try to assess, is this normal behaviour for a profit maximising firm", it has some unusual characteristics. It is not the whole story, but it is part of the story. This appears very clearly from the record.

Could we then go to the question of the margin that is then said to be relevant. It begins at p.38, line 6:

> "Q If those 25 buses did turn out to be profitable, what kind of net present value would the provision of those services have? Any thoughts?
>
> A ([Stagecoach Director]) We did not do any calculations. I have tried ..."

and I have read that bit. Then the question is:

> "Q I guess I am trying to understand. You are making some significant investments in loss-making services. As you say, when you introduce a new service on to a route, it takes a while for the client base to build and in those instances it seems to have taken quite some considerable time for the services to cover the direct costs, so the non-trivial investment in entering to get a quarter of the business of Preston Buses. I am just trying to get some indication from you of

– if that had been the outcome, as you say, and you would have been happy with it – whether or not the outcome would have been consistent thinking of the kinds of investments that you are obviously making in this entry strategy."

A. ([Stagecoach Director]) All we are looking to achieve in the long term, with really any of our fleet, competition or not, is that each of the services we operate would hopefully make a 10 per cent profit at depot level. That includes depot overhead costs. It does not include recruitment overheads and so forth. And hopefully, more than that. Less than that are services that we question constantly and what can we do to get them in [X]."

Then there is a discussion around the [X] per cent margin, and it is picked up, just for the sake of brevity, but I think it will be clear how this emerges, the question is asked at line 11:

"Q You do not even think about it in those terms?

A ([Stagecoach Director]) Not in precisely those financial accounting terms.

Q Not even qualitatively? Profit?

A. ([Stagecoach Director]) Do we think it is a worthwhile investment to spend a year developing seem to me business that hopefully will generate [X] per cent margin or better for the next ten years?"

Then there is a discussion around how you can do this rule of thumb where you can get an estimate, which is done at p.40, as to how you will secure a return at that 10 per cent hurdle rate. That is [Stagecoach Director]'s conception of what is a reasonable return on buses. The relevance of this discussion is not that [Stagecoach Director] is saying, "This is what we expected to get on these 25 buses", this is [Stagecoach Director]'s account as to what in his business he considers to be an acceptable rate of return.

Perhaps just to read this full passage, at the foot of p.39:

"Q Twenty five buses. Thank you for the correction. On the face of it that seems like a fairly simple calculation for a bus man. On that would be at the front of your mind, if you were thinking about these issues.

A ([Stagecoach Director]) In terms of ongoing business, yes. They are always in the front of my mind. I know what a bus should be able to do and what I want it to do, yes.

Q So annual returns to having 25 buses running in Preston?

A ([Stagecoach Director]) Well, I am trying to put some numbers to you – and I have to say these are not the way I would normally think of it."

So [Stagecoach Director] is trying not to be drawn on the subject, and he then says:

> "Typically I would expect an all day bus, as opposed to a peak only bus, to generate these days up to about £[X] a year in revenue. These are minibuses, which might be only £[X] a year in revenue. I am looking for at least a margin of [X] per cent. Our best services do [X] and [X]. At worst, I am looking for [X] per cent of £[X] turnover a year, £[X] a year operating profit for [X] years for the life of the vehicle. What does it cost to develop that service to get that amount of money? I think less than £[X] we would get in the long term, but then I have got in the very long term.
>
> It all depends on how long it takes to achieve profit and that is the real uncertainty. It is so uncertain and is why we do not try and project revenue. I could do an optimistic and a pessimistic projection. It would not tell me any more than I could work out in my head.
>
> Q You say you did not even do that calculation in your head?
>
> A ([Stagecoach Director]) I do not consciously do them."

So all that this passage shows is that if [Stagecoach Director] is pressed to work out what he thinks is a reasonable return for the acquisition of a bus, this is his rough and ready calculation. It says nothing whatsoever about what he actually thought these buses would return over any timeframe. This is entirely [Stagecoach Director] being pressed in questioning. He says, "I do not make these calculations, I do not do projections, I have not done any of these things, I am not willing to be engaged on this matter", and when pressed and pressed and pressed, eventually this is what he says. Indeed, it is clear if one looks at p.48, line 8, the sentence says:

> "Typically I would expect on all day bus, as opposed to a peak only bus, to generate these days up to about £[X] a year ..."

So he is just doing, as it were, a general rule of thumb.

The relevance of this is, one, they did not do any of these projections. They had no idea as to when they would break even and against what timeframe. When pressed he says, "This is the kind of return I would look for, and whether I can get it or not is far too complicated to make any sorts of projections, I just literally do not know one way or the other". That is what [Stagecoach Director]'s testimony is.

We are in the helpful position where we can actually see what happens. This was the second exercise that the Commission undertook. It was not a simply a question of, "We asked Stagecoach what their views about profitability are and what the relevant time lines are", in respect of which all that is generated is very, very vague responses, and very little that is done by way of revenue projection. There is then a detailed analysis that is offered in the annexe as to profitability, and perhaps I could ask the Tribunal to refer again to appendix G. That analysis is done at G7. Just by way of introduction and perhaps trying to simplify this analysis, there were various ways of looking at profitability and the one was an incremental costs analysis which was one favoured by Stagecoach. It had a number of assumptions in it which were, at least in the Commission's sense of things, somewhat restrictive because it did not allow for depreciation and it did not allow for certain of the pension costs attributable to the drivers. Then there was an allocated direct costs measure which was the normal accounting treatment that Stagecoach utilised in their ordinary business accounts. Finally, there was a total allocated costs assessment that was made. If one had regard to those figures - and much of it is confidential, but I will make the submissions we wish to make without referring to the actual numbers - one sees in Table 2, at G8, that this is done on the most favourable view. These are all Stagecoach's figures, drawn from their accounts. This is incremental contribution which makes no allowance for fixed costs and makes no allowance for depreciation or certain of the costs that are associated with hiring drivers to drive these new buses. What one sees on the incremental contribution which is the last line on Table 2 is that in the first period there is a very significant loss, and in the second period that loss has diminished, but still remains loss-making. So, over the period as a whole one sees significant losses that are sustained, and none of that takes into account, as one reads in para. 30, any allowance for the losses that are attributable to retaliation. If one reads in the third last sentence in para. 30:

> "Stagecoach has not calculated an estimate of the effect of PBL's retaliation in 2008 and 2009. If we assume a similar loss on Route 3 in 2008/2009, since the conditions of competition on this route remained broadly similar until the merger, then the 2008/2009 loss to Period 9 would be increased [and it indicates the incremental amount]".

In para. 34 one observes the note is made,

> "As we have noted above the new routes were approaching break-even on an incremental cost basis at the time of the PBL acquisition. We note that in the long run these incremental costs will increase as warranties on the buses expire and drivers become eligible for pension contributions. In order to cover the cost of capital associated with these routes further contributions would have been required from them. Additionally, Stagecoach's aim was to improve the profitability of the

> Preston depot which would have required a contribution in excess of the incremental costs".

So, in other words, on the most favourable view of costs, one sees significant losses throughout the period.

The second measure - again, all drawn from Stagecoach's figures - is an allocated direct costs measure which, as indicated in para. 35,

> "We also reviewed the contribution of each of the six routes based on Stagecoach's allocated direct costs which Stagecoach produces as part of its allocated total costs data. Allocated direct costs include drivers' costs, fuel, insurance, bus depreciation, maintenance [and there are details in Annex 4]. For the most part, we considered that the allocations of costs were reasonable for our purposes".

Then, if one looks at the allocated direct costs methodology, again one sees significant losses in both periods as reflected in Table 3. If one wants to examine how that is depicted route by route, one then sees in Figure 2 that on virtually every one of the routes there are sustained losses that are being made over the period.

At para. 41 there is further commentary made on the period of time and how these losses should be assessed. It says,

> "Assuming that Stagecoach could continue to increase the fares at the same rate without losing passengers and hence continue to grow its revenue at the same pace as it did during the period P7 of 2007/2008 and P9 of 2008/2009 (we note potential difficulties with this in para. 40 above), the revenue generated on Stagecoach's Preston city routes would only start covering the allocated direct costs of these routes in 15 more four-week periods. This means that in total it would take 33 four-week periods [which is effectively three years] from the launch of all six routes for Stagecoach to recover just its allocated direct costs on the new intra-urban routes. This is considerably longer than even the longest estimate of time that other bus operators told us they would require to achieve an overall profitability, let alone cover their direct costs".

So, the assessment that is made on the second measure, which is making no allowance for the recovery of the capital that has been put into this project, and any allowance for the fixed costs, on this basis is a time period indicated, which is indicated to be considerably longer than would be the norm.

There is then a consideration of the total allocated costs. This is where one is adding in the fixed costs of head office, the depot, and the like. In Table 5 - again, without referring to the figures - one sees that the operating profit compared with losses sustained on the new intra-urban routes is depicted over the various periods.

THE CHAIRMAN: Which is the table for the total allocated costs? It is not a graph. It is not Figure 5, is it? It is Table 5.

MR. UNTERHALTER: No. It is Table 5. I beg your pardon. I should just clarify. Table 4 is the measure of total costs and the losses that were incurred over the two periods. Again, without stating the numbers, one sees the total allocated contribution in those two years are reflected. They are significant. Then, the impact upon the depot is considered at para. 47. There too one sees that the point of this enterprise was meant to be to restore the profitability of the Preston depot. What in fact happens - and this is a point which the Commission emphasises in their consideration of the matter - is that a modestly profitable depot is now rendered unprofitable over the period. That is what is depicted in Table 5. So, the conclusions that are then derived from this analysis set out in G is to be found at para. 61. The following is said there,

> "We found that :
>
> (a) following the launch of Stagecoach's intra-urban services, service levels in Preston were unusually high. Stagecoach considered this level of service to be unsustainable. The service levels were lowered considerably following the merger".

Again, an important point, which is that what happens after the merger is that it is not possible to keep this kind of capacity in the market, and so predictably it falls off considerably. That is another pointer to the suggestion that what is being put into the market by way of capacity in the eighteen month period is not sustainable, and the corrective is clearly indicated in this report in Annex 2 at G22, where there is an assessment of the changes in frequencies over the period. One sees there are capacity declines which is at the commencement of the period, in the run up to the merger and then afterwards, so that is one of the conclusions. This is not sustainable and the post-merger activities indicate why. Then:

> "(b) Passenger numbers in the Preston area increase by 12 per cent during the period of operation of Stagecoach's new intra-urban routes up until the acquisition of PBL. However, following the merger passenger numbers decrease to 4 per cent above the level that existed before Stagecoach launched its new intra-urban routes.

(c) Regardless of the cost method used, before acquiring PBL Stagecoach incurred heavy losses during the period of operation of the new intra-urban routes, and it is doubtful that it would have been able to achieve a level of profitability under the pre-merger conditions that would have covered more than the incremental costs.

(d) In the 20 four-week period of Stagecoach's operation of the new intra-urban routes until the acquisition of PBL, Stagecoach covered the incremental costs of the routes in only one four-week period. The incremental costs were just covered in P8 by [an amount]"

Then:

"(e) The new intra-urban routes continued to make significant losses for longer than is usual among large bus companies.

(f) Stagecoach's operation of the new routes resulted in a contribution reduction of [an amount] on its key routes; this seriously damaged PBL's operating performance."

I have gone through this in some detail only for this purpose, which is that that is the exercise that was done by the Commission to investigate the question of profitability. I do not doubt that one could examine these figures in other ways, think about profitability under other conceptions, but is this a rational approach to the determination of the issue that was at stake here, which is: was this sustainable competition, and was this conduct of a profit maximising firm? Was it an available, permissible conclusion to reach? We submit on this data it was, because the components of it are sustained loss-making ----

THE CHAIRMAN: But you went a bit further than that though, did you not? I do not think necessarily Stagecoach would say that this level of capacity was sustainable in the long term. What they say they expected was that they would put on this capacity and PBL would retrench. But I think you went a bit further – and this is the problem, potentially – to say: "This could not have been continued in the long term", to say: "And we draw the inference from that that the evidence that we have heard from Stagecoach that their intentions were limited and that they were not aiming to drive PBL out of the market, that we reject that evidence in part on the basis of the conclusions that we draw". Is that a fair assessment?

MR. UNTERHALTER: It is, but that second conclusion, although one that was drawn, is not fundamental to the decision that is ultimately taken, because whether or not Stagecoach did seek some share of the intra-urban market or not is not critical to the question as to whether the intervention that it in fact made was not profit-maximising, sustainable competition.

PROFESSOR BAIN: Let us come to whether it was profit maximising behaviour with a sound commercial rationale. The whole of your appendix G is predicated on the assumption that PBL do not retrench. Nowhere in appendix G do you consider what the outcome would have been if PBL had retrenched and the strategy had been successful. If you are going to make a proper financial assessment of the commercial rationale you have to do it on the basis that it would be successful. Now [Stagecoach Director] did provide some figures – when pressed – in which he said he hoped to get £[X] a bus a year if it was successful. Did the CC do any work using those figures to see if there would be a commercial rationale if the strategy was successful?

MR. UNTERHALTER: Well it did consider the question as to whether PBL's response ----

PROFESSOR BAIN: I am sorry, I am not asking about PBL's response. From the point of view of the commercial rationale of Stagecoach they have to look and say: "What do we expect to happen?" What they expect to happen is that in due course, timing being pretty uncertain, PBL will retrench. What they have to do is have some idea of what it is going to cost them, and you have calculated what it did actually cost them, which may or may not be what they expected it would cost them, but you have some figures on that. They have to look against that at what they hope to gain in the long term. I am sorry it is "Econ One" stuff.

MR. UNTERHALTER: Absolutely.

PROFESSOR BAIN: It is simple investment appraisal. That is what they have to do. Did the CC do any calculations to look and see whether there would have been a commercial rationale on that basis?

MR. UNTERHALTER: The short answer is "no" they did not.

PROFESSOR BAIN: Thank you.

MR. UNTERHALTER: But, if I could explain because it is important, nowhere that we have seen in the record does [Stagecoach Director] ever say: "We did a projection against the rationale that we claim which is that we sought around 25 per cent of the market, that we could secure a level of profitability and the key assumption that that was based on is X or Y degree of retrenchment."

THE CHAIRMAN: We have read the exchanges there and we understand the inference that was drawn from them, or how the Commission used that and it is up to us to decide whether, on the basis of the high test which you have explained, and I think we accept, whether we consider that that was a possible construction of what [Stagecoach Director] said, and I think we have read through the evidence now, and we will have to come to that.

PROFESSOR BAIN: One small question – a question of fact. Would you agree that the prediction that it would take "N" months for Stagecoach to reach profitability on an allocated costs basis is also predicated on them not gaining passenger numbers, because you have shown passenger numbers levelling off, that being a situation in which PBL had not retrenched?

MR. UNTERHALTER: Clearly the question of the response of the competitor to an entry is a key variable that one would ordinarily think about in relation to whether a particular strategy is likely to work or not, and against what time horizon, and in respect of what kinds of hurdle rates one might seek to achieve over time.

PROFESSOR BAIN: Yes, but ----

MR. UNTERHALTER: If I might just complete the submission because it is simply this: none of that, what one would ordinarily expect is that a firm that is making this kind of investment would be undertaking the very exercise that is being posited. All that [Stagecoach Director] is saying is: "Typically, I have a particular return in mind. I did not have that return here, I did not make any assessment as to what the reaction of Preston was going to be, and what its impact would be upon my time frame, and when I might make it profitable, and whether I was willing to take that risk against various scenarios." None of that was done, which one would ordinarily expect if there were a rational approach being made to an investment. So, with respect – and this is my concluding submission on this score – it is not for the Commission to determine what, in some hypothetical world could be the right rationale that would be rational. It assesses the evidence as to what was done and what was said about the reasons for making the intervention, and when one assesses the evidence of that one sees how slight were any real rationales for what was done, they are just airy words, saying: "We had no idea why we were doing this, we just wanted it and so we did it, and we made a £[X] investment to try and secure it."

PROFESSOR BAIN: You seem to be saying, Mr. Unterhalter, that in the absence of documentary evidence of the kind you would expect in Shell, or companies like that, it could not be a rational decision. That was how what you said came out. You did not see any of these calculations so you infer from that that it was not rational.

MR. UNTERHALTER: With respect, it is not a question of whether there is documentary evidence. Of course, standardly, documentary evidence is helpful because it is hard to engage in ex-post rationalisations if there is a contemporary record, but the key question here is that the questions and answers that were given did not yield the kind of forecasting that elementary business would ordinarily suggest would be required. That is the key point.

When one assesses this evidence, that is the assessment that the Commission made. Again, just to come back to the standard of review, all that has to be established is that, looking at this evidence, this is an inference that could reasonably be drawn. It may not be the only one, there may have been other ways of looking at it, but this was a reasonable inference to draw.

It is pointed out to me, and possibly just for the sake of completeness, if I could refer you to the decision at para.5.61. The reaction of PBL was certainly considered, not necessarily against a business plan that one might rationally have expected Stagecoach to have adopted, but nevertheless what PBL's reaction and response was a matter that was considered. There one sees that the argument of Stagecoach is reflected:

> "Finally, Stagecoach argued that it was PBL's irrational response to its new services that was largely to blame for the company's demise. We recognised that there would have been a number of possible reactions to the launch of Stagecoach's new services open to PBL's management at the time. It might, for example, have de-registered services or held steady rather than invest. We did not think it was possible to establish with any degree of certainty what other outcomes might have resulted from different strategic decisions by PBL and subsequent behaviour of Stagecoach, given the number of variables that would need to be considered and the lack of factual evidence to assist us in making such an assessment. However, we did not consider that the de-registration of services by PBL, or a decision to hold steady would have been significantly more likely to have allowed PBL to maintain a significant ongoing presence in the Preston area: there was nothing to prevent Stagecoach, with the resources available to it, from then further increasing the number of buses it operated in the Preston area whenever it wished to do so. We also found it difficult to reconcile Stagecoach's argument that it wanted to grow the Preston intra-urban market, while at the same time arguing that it wanted to acquire only some 25 per cent of the Preston intra-urban market by expanding on PBL's routes and expecting PBL to retrench.
>
> In our view, the reaction of PBL was not unusual in the context of the bus industry."

There is an assessment that is made and it is said to be one that is not irrational, not unlikely. There is perhaps just one last submission that flows from this, which is that when one is thinking about Stagecoach's entry into the market, the intra-urban segment of the market, the equilibrium that it established up until 2007 was predicated on the fact that PBL maintained high frequencies and low pricing and had very low margins. That was part of what was assessed by way of the competitive interaction between the firms and has not been challenged.

One has to then consider how an entry into that kind of market, where there are very low margins that are being enjoyed by the incumbent in that segment of the market, is just, of itself, the most fertile basis for trying to secure better returns for yourself so as to shore up the Preston depot.

THE CHAIRMAN: If the low margins are because the costs are high and you have got much lower costs, then you can come in. That is the absolute paradigm of competition, is it not, that you have got and inefficient operator that is making low margins because it has got high costs; you are a low cost entrant, you can come in and charge just below the prices and make a nice margin yourself.

MR. UNTERHALTER: You can, if you can do the calculations to show that you are positioned in that way.

THE CHAIRMAN: Yes.

MR. UNTERHALTER: If Stagecoach had presented something that looked like a plausible business rationale backed up by – not detailed documents, they do not even have to have documents – something which shows why this was a plausible intervention in this kind of a market, then one would have greater reservations about the way in which the Commission determined this matter. It is the paucity of anything that amounts to a sensible business case for entering that, in our submission, certainly supports the conclusions that were arrived at and certainly does not render them in any way irrational.

That is the one key building block and probably the most important issue from the point of view of what it was that was key to the decision, and we have made our submissions on that score.

MR. THOMPSON: I do not want to disturb Mr. Unterhalter, but in response to a question from the chair, I did get the impression that he said that the inference was drawn that it was the intention of Stagecoach to drive PBL out of the market. That is something specifically that does not appear in the decision.

THE CHAIRMAN: That may have been my sloppy wording, Mr. Thompson. I think it is clear from the decision that there was no finding about subjective intention.

MR. THOMPSON: I assume Mr. Unterhalter is not changing position on that. He seemed to be, but I would just be grateful for clarification on that.

MR. UNTERHALTER: Not at all, the essence of the decision is precisely that although there are questions posed about what they were aiming at and whether they were or were not trying to drive PBL out of the market, the fact is that that is not what the decision found at all.

There is, and this is the second, though, in our submission, altogether subsidiary question, which is that the scrutiny that is given to the question of the 25 per cent share, and we have been to the relevant passages which reflect how that number arose, and I think again fairly, as the Commission understands it, this is the sort of late arriving rationalisation because I think, as my learned friend very fairly indicated and I think the evidence makes plain, this is just an absolute sort of, “Well, we have gone 25 buses and Preston has got a roughly 100 on the commercial route, so we were trying to get 25 per cent”. It is simply an *ex post facto* rationalisation. It is not, as it were, saying that is the target that we were trying to achieve, because that is not how the evidence reads. In any event, that does seem to become one of the key matters that is relied by Stagecoach to suggest, “That is what the intervention was based on, and why do we say otherwise”.

If I could refer the Tribunal again back to the decision, and in particular para.5.10, this is where the Commission introduces the developments of the operations in the area and the new service that was being offered. Could I pick up the reasoning at the foot of p.18:

> “Stagecoach gave us several reasons for this move. It told us that it sought to pre-empt the acquisition of PBL by another operator, as it was concerned that a competitor with a more proactive approach to network development might threaten its own operations around Preston.”

So the point that my learned friend emphasised a number of times in his address, which is, “This is was one of the reasons”, is fairly set out in the decision as one of the matters that Stagecoach relied upon.

> “It also told us that a more efficient owner of PBL would make it more difficult for Stagecoach to gain market share in Preston, as explored in more detail in [these various paragraphs]. It told us that it intended to establish a significant minority share (perhaps 20 to 25 per cent) of the Preston market, thereby improving the profitability of its Preston depot. Finally, Stagecoach said that in addition to gaining market share, it wanted to grow the market in Preston.”

So, there can be no question that the Commission fairly puts the various reasons that Stagecoach offered for the intervention that it made. There is, then, in para. 5.11 a reference to the difficulties encountered in trying to measure these claims against the documentary record. Again - and I do not think I need to detain you on the score -

Appendix F goes through this, and it makes it clear that this was a difficulty, just from the point of view of assessing evidence, but it draws no inference whatsoever from the fact that documentary record is sparse and, for the most part, unhelpful, and, to the extent it exists, they were mainly cost estimates and made no revenue projections whatsoever. That is the record and it is set out in Appendix F.

Then the Commission says,

> "In seeking to understand for ourselves Stagecoach's actions, we assessed all the evidence carefully and made the following observations ----.

Again, here we are going into the exercise of how the Commission assessed all the evidence. On many occasions Stagecoach has said, "But [Stagecoach Director] said X --"or, "Stagecoach contended Y" as if the mere saying of those things somehow must be accepted. The role of the Commission is not to simply accept things because Stagecoach says them, but to assess them against all the evidence. That is precisely what it proceeds to do. There is then a recitation in 5.12 of a number of factors, many of which we would submit are common cause for the most part, but it explains the various conflicts that arose as to what occurred in the meeting with PBL prior to the intervention; whether there was, or was not, any threat of competition. You will note at 5.12(c), in the last sentence,

> "However, given the conflicting accounts we do not place any decisive weight on this".

Within two weeks there is a business plan. Then, the 25 new buses were provisionally ordered for this plan by late Autumn, based on rough and ready figures of what it would take to establish a credible level of competition in Preston and not as part of Stagecoach' normal internal bidding process. That is referred to in Appendix F.

Again, it is another piece of evidence - not dispositive in and of itself. But, as [Stagecoach Director] explained when he was questioned, there was a normal bidding process because throughout the company they buy many fewer buses than the various managers across the country would like to deploy. The basis upon which the rationing process takes place is that they buy buses and put them on routes where they expect the highest return. It is on a profitability basis. That is what [Stagecoach Director] explains.

This acquisition, though, is not done on that basis. It is said not to be done on this basis because this is a speculative intervention. Again, it is just another piece of evidence which suggests that somehow or another this was different from the ordinary principles you would expect, which is that the Preston area of Stagecoach would need to compete with other areas as to why this is a better place to invest over £[X] in somewhere else. Again, if one is thinking about the rational profit-maximising firm, the ordinary consideration would be, "Well, what is the opportunity cost of deploying this investment in Preston versus some other route where there would be a higher level of profitability?" There is no such calculus that is made - although [Stagecoach Director] explains that that is the normal way in which these things are done, as one would expect.

So, again, another piece of evidence, cumulatively part of this picture, which tries to understand what is being done here, and whether it is in any way a form of normal competition.

At 5.12(f) the investment is reflected; the number of staff. Then there are projected costs and revenues which ultimately were produced, though they were not produced at the time. They are referred to. Then,

> "Stagecoach's new services were all launched in direct competition with PBL's most profitable routes [a matter my learned friend has referred to] and Stagecoach's fares were set below those of PBL with significant discounts offered on daily and weekly tickets".

Again, on one account of this, this is what you would expect if you are going to try and secure market share - plainly. The question though is: Was this profit maximising behaviour? What is happening is that by so doing you are making very significant losses. So, you are going into this market -- Yes, you acquire market share predictably. But, anyone can gain market share by losing money. The question is: How do you gain market share and not lose money and make it profitable? That is the background.

So, the question of the fact that they targeted the most profitable routes is simply to show that what is happening here is that they are offering deep discounts and not making any money out of doing so, over the timeframes (which we will come to in a little more detail). So, that, too, is simply part of the picture in trying to get an assessment of whether this is ordinary competition on the merits.

> Although the new services were allocated a codename, we saw no internal documents. There did not seem to be any significant gaps in PBL's network of services and the new services largely duplicated those".

So, you have significant entry across, effectively, all of the intra-urban services offered by PBL, significant cost-cutting and it is - and this is a point I shall come to - in essence the scale and frequency of this entry and the losses that it brought with it for both companies that is ultimately thought by the Commission not to be indicative of ordinary competition on the merits.

Then, one will see reflected at (l), “Other than the possible future prospects of PBL being taken over by a third party there did not seem to be any urgency or strategic reason for the timing of the expansion”.

Then consideration is given to the uncertainties that this generated, and risk involved.

> “Stagecoach launched its planned new services over a period of nine weeks rather than a progressive build-up of services. The reason Stagecoach gave us for launching the new services in rapid success was the benefit of a launch of a portfolio of services under a common brand.”

That then sets out the basic circumstances that were thought to be relevant in trying to get a picture overall of what had occurred here. Then, just to follow the scheme of the reasoning, the effects of all of this are then debated. We have dealt with that under the consideration of profitability and what that has meant.

The conclusion on profitability is reflected at para. 5.30. If I might just very briefly refer to one or two passages there because this goes to the question of the relevant aim --

> “Stagecoach told us that by operating the new services it aimed to gain 20 to 25 percent of the Preston market and thus improve the profitability of its Preston depot. It seemed to us that absent a radical change in the competitive situation such as significant, if not total, retrenchment of PBL or its acquisition by Stagecoach there was no reason for Stagecoach to think that these new services were likely to improve so significantly so as to achieve an improvement in the profitability of the Preston depot”.

So, there again a consideration of PBL’s entrenchment, but absent an almost wholesale retrenchment, so it was found, with no prospect of profitability.

> “In fact, it seemed more likely to us that these services would remain essentially unprofitable or, at best, marginal. It was hard to see how Stagecoach could expect to recoup its investment of £[X] million in new buses on this basis. We noted that Stagecoach significantly reduced services provision in Preston”.

We have seen some of the consequences of that.

Then there is a consideration of the impact on PBL and then at para. 5.45 there is a return to the subject of the market share objectives, and again I do not want to read it all, but there is one passage which is of particular importance in the reasoning and that is at para.5.47, because this tests the real impact of the form of intervention that took place, and in particular its scale and frequency in respect of the services that were offered. At 5.47 the following is said:

> "We found that Stagecoach launched five services over a short period of time (around nine weeks), largely duplicating PBL's most profitable commercial routes which represented … [a certain amount] of PBL's direct contribution. Although PBL had a fleet of 127 buses in total a significantly lower number of these buses served the commercial routes. Based on PBL's route costing data, we estimated that PBL operated 49 vehicles on the routes which Stagecoach targeted with its new intra-urban services. Given that Stagecoach's new services were supported by 25 new vehicles, the level of supply on these crucial routes increased by approximately 50 per cent, following Stagecoach's entry."

So again it is all very well to take this rule of general 25 per cent market share figure, when one examines the form of entry and where it was targeted one actually sees that it is much, much more like 50 per cent in respect of the key routes which contributed the greatest portion to PBL's revenue.

THE CHAIRMAN: But is it your case that Stagecoach knew that?

MR. UNTERHALTER: It is not the case that it knew this to be so, the question is: what is the effect of it? Again, all of this is simply about ----

THE CHAIRMAN: It does matter whether they view it to be so, if you are inferring from the identity of the routes that they went on to, and the amount of capacity that the inevitable result, or almost inevitable result was that PBL would exit the market.

MR. UNTERHALTER: Yes, I think just to be clear about the scheme of reasoning here, the 25 per cent figure is offered by Stagecoach. There is an assemblage of evidence which is put up which essentially gives rise to doubt as to whether that could really have been the rationale behind the intervention. But ultimately the Commission does not need to make its determination of abnormal competition upon whether that rationale was 25 per cent or not, it is just one factor that this evidence is marshalled simply to, as it were, set the context within which one looks at the ultimate effects that were felt. But it is true that, of course, the thread of all of this is to be doubtful about the 25 per cent claim, but it does not ultimately need to make a finding as to whether that was or was not the objective with which the intervention was made.

PROFESSOR BAIN: Can I just ask you to think again – or correct me if I have misheard you – I thought you said that Stagecoach were going for about 50 per cent of the market because the capacity was increased by 50 per cent . If the capacity was increased by 50 per cent that would correspond to one-third of the market if all the buses were the same size. Your own figures, which you pointed to us earlier on, suggest that they actually had between 20 and 25 per cent.

MR. UNTERHALTER: I was not seeking to suggest they had 50 per cent of the market, I was simply following the reasoning in 5.47 which was to reflect that there was an estimate made that PBL operated 49 vehicles on the routes which Stagecoach targeted with the new buses. In other words, if you take that subset of targeted routes and then ask what proportion did 25 buses make of that subset, then that is what ----

PROFESSOR BAIN: It means it is a third of the market that they are going for?

MR. UNTERHALTER: Well that of course depends on ----

THE CHAIRMAN: That depends on whether they grow the market.

MR. UNTERHALTER: If the market, as the decision makes plain, is all commercial services then that would not be so. But to make it plain, I think the point is not to suggest that there is a higher market share overall, it is simply indicating what the impact is over the relevant routes which were targeted.

THE CHAIRMAN: Yes, assuming that those 25 new buses were supposed to replace 25 of PBL's 49 buses, then you could expect that to make really quite a big dent in PBL's business.

MR. UNTERHALTER: Yes, and then there was an assessment made as to where PBL made its money and what the impact was on PBL's bottom line, and again I do not need to go through that, but in essence it has quite significant consequences.

There is then a recitation and again I do not want to spend unduly long going through all of this, but there is reasoning which indicates what the impact of all of this has been on the relevant market and one sees at 5.48 that Stagecoach expanded on these various routes which meant that effectively nine out of the remaining eleven services were targeted, so it went for a blanket coverage pretty much on the intra-urban routes. So again, the question is, and all of this is just cumulative evidence of trying to understand the behaviour and form of entry, but it did not go for any form of incrementalism, it went for a widespread entry into the market across all the routes with high frequencies, very low fares and with the losses that were generated in consequence.

All this leads at 5.53 to the following:

"The scales and nature of Stagecoach's expansion described in paragraphs 5.45 to 5.51 would not seem to us to suggest that it was only aiming at gaining a minority share of the Preston intra-urban market. In our view, it was predictable from the outset that Stagecoach's entry on all of PBL's key routes would cause considerable damage to the viability of PBL, rather than merely enable Stagecoach to acquire a minority share of the market."

So that is ultimately where the conclusion lies in respect of this. Then at 5.77 there are the conclusions that are then drawn from this fairly extensive analysis that is offered, and of particular importance we would draw the Tribunal's attention to para. 5.81 and 5.82. At 5.81:

> "Stagecoach repeatedly denied that its entry to the market was part of any acquisition strategy."

THE CHAIRMAN: Does that mean acquisition of PBL?

MR. UNTERHALTER: Yes.

> "Much of the evidence we have seen would be consistent with an objective of driving PBL out of the market; but other evidence may suggest otherwise, and objectives may indeed change over time. However, we do not need to conclude on Stagecoach's intentions and they are not critical to our analysis given that we are satisfied that the effect of its actions during the period of abnormal competition was to drive PBL out of the market."

And that is, through all the debates that have taken place, the critical conclusion. It is not a question of what they intended, it is a question of what consequences their intervention had, and they intervention that they engaged in had the effect of driving PBL out and that was not an incident of normal competition or ordinary competition, call it what you will.

Then in 5.82:

> "Hence Stagecoach's conduct in the two-year period that preceded the merger had the effect of driving PBL out of the market and/or rendering it unattractive to a potential purchaser, conduct that Stagecoach pursued with little regard for profit and normal commercial considerations."

That key phraseology.

> "The character of Stagecoach's entry into the intra-urban market in the period that led up to the merger situation and its effects on both its own Preston operations and on PBL are relevant in our consideration of the counterfactual ..."

Hence the link between this entire discussion around profitability, the question of what effects that intervention had, the fact that the Commission came to the conclusion that it marginalised PBL rather than was aimed simply at some acquisition of some market share. All of that then leads to the proposition about not motivated by normal commercial considerations, and that then is the substance of the counterfactual which then follows.

On the two key points, the one is what were the effects, the Commission concluded that this was conduct pursued without proper regard to profitable intervention, it was not sustainable and the effect of it was certainly to marginalise Preston, whether that was the objective or not. That is built up on the evidence which we have now traversed.

THE CHAIRMAN: Can you then take it the step further and describe how the conclusion in 5.82 affects the counterfactual that you chose and also how it affects the scope of the remedy that was ultimately ordered?

MR. UNTERHALTER: The consequence of it for constructing the counterfactual is that because the 18 month period was characterised by an intervention and a set of consequences that were not part of sustainable ordinary competition, that period is then not utilised for predicting what would happen absent the merger. That then becomes the content, as it were. In other words, it is the criterion by reference to which the counterfactual is constructed because in deciding what is the right proxy for the market without the merger. It is not what happened in the 18 month period that is judged to be the correct proxy of ordinary rivalry in a market, it is rather the kind of rivalry that was sustainable in an earlier period.

THE CHAIRMAN: So looking at 6.13, one of the things I have struggled with a little is:

> "We therefore concluded that the appropriate benchmark ... was the competitive situation which prevailed before the launch of the new intra-urban services by Stagecoach in 2007 PBL would most likely have continued to operate buses in Preston in much the same way as it had done in preceding years. Stagecoach Preston would also most likely have continued to operate on its old routes ..."

If one was to finish that sentence by saying, "Stagecoach Preston would also most likely have continued to operate on its old routes" – if what? What is the underlying assumption that you make as to the market in order to sustain the finding that it would most likely have continued to operate on its own old routes, if what? If it had thought that it would never be allowed to acquire PBL, or if it had thought that PBL would retaliate in the way that did or what? Am I making the question clear?

MR. UNTERHALTER: I think the answer to that is simply to say if no merger had taken place and this ferocious engagement had to come to an end and did, the likely position that Stagecoach would have gone to or would have adopted would have been basically to be in the inter-urban sector of the market and then sought other means improving its profitability. There are many permutations as to what that might have been, including the possibility that it would look for opportunities on intra-urban routes. It does not preclude that possibility.

It simply is saying that the extent of its position in the intra-urban segment is not one that was sustainable and, therefore, assuming no merger was proposed there would have been an equilibrium established along the lines of what is captured in this paragraph – in other words, it would have certainly continued strongly on its inter-urban segment, which it had always been powerful in, and would then have looked for what might be sort of opportunities to become more profitable but not under abnormal conditions – in other words, under conditions of ordinary rivalry. I think that is the sense that is sought to be conveyed by the language in that paragraph.

There is just one exhibit I wanted to refer you to as to the question of Stagecoach's intentions to the extent that they are analysed. It is in the exhibits to the defence, tab 1. These are the initial submissions that were made on behalf of Stagecoach. At p.6 under para.2.4, this is what is said by Stagecoach.

THE CHAIRMAN: This is labelled "Confidential", but it is not in yellow. Can I assume that it is all right for you to read it out? Yes.

MR. UNTERHALTER: The first sentence in 2.4:

> "Stagecoach saw the possibility of growing the overall market for bus travel in Preston. A number of services within Preston were registered and commenced operation ... The network was operated by 25 new and 3 nearly new Optare Solo minibus vehicles at an investment cost of £[X]. Stagecoach also invested in other larger vehicles for operations in and around Preston ..."

Then the following is said:

> "The services were intended to complement existing operations of Preston Bus and, in so far as possible, Stagecoach scheduled its timetables so as broadly coordinate with, rather than duplicate, those of Preston Bus."

That is how it put the matter when it made its initial submissions. That is one further factor which tends to indicate that the notion that it was simply seeking some incremental share in a reasonably benign way in the market, which is how it first put the matter, and one then assesses all the evidence as to what happened here, how it indeed intervened and with what consequence, a very, very different picture emerges. This was not a complementary intervention seeking to grow the overall size of the bus market. On the contrary, it was a highly targeted intervention with massive consequences for PBL that rendered PBL considerably vulnerable to takeover with all the consequences that followed. That too would be relevant to an overall assessment.

Those are the two fundamental grounds. There is a plethora of small matters, such as the lack of business records and the targeting of profitable routes and other such matters. We have dealt with them extensively in the annexe to our defence and I do not intend to go back over that ground unless there are any specific questions that are posed.

We submit fundamentally that when one steps back from this intense engagement with all this detailed evidence around the nature of the intervention and particularly its effects, the Commission took a view as to whether a market that was said by all to have a sustainable basis for two operators was ultimately one where in this 18 month period you could say that this intervention was simply an ordinary part of rivalry or not. It came to the conclusion that it did.

We submit that on any view there was a very considerable body of evidence that was considered for this purpose. It was not, as it were, as if the Commission simply had a preconceived idea as to what was happening in this market. For the purposes of deciding the counterfactual it carefully investigated the dynamics of the market over this eighteen month period. It looked at everything Stagecoach had said. It considered what the impacts were. We submit that one cannot say that the conclusion reached here is irrational. One might say one could have drawn other conclusions. But, that simply is not the test. So, for those reasons substantially we would submit that Ground 2 as to the really fundamental features of that challenge cannot be sustained.

There remain, though, two topics that I do lastly want to tackle. That concerns the issue of third parties. Then I do want to make some submissions briefly on the question of remedies. I wonder whether it might be possible to take the short adjournment now if that were possible?

THE CHAIRMAN: Mr. Blair has a question, but, yes, apart from that I think we will do that.

MR. UNTERHALTER: Possibly we could go into Camera upon reconvening so as to protect the third party confidentiality.

MR. BLAIR: I may be behind my colleagues, as I think I was yesterday, but I have been puzzling about the relevance of the abnormal competition to the crucial question, and the nature, of the link that is mentioned at para. 5.82 of the Decision. Can I put it to you and see whether you agree or disagree with the following propositions? First of all, the Commission is not a regulator of the conduct of business of competitors in a market. So, there is no question of disciplining Stagecoach on account of their aggressive behaviour during the period of abnormal competition. There is no question of disciplining them - which was in any way lawful - for their unusual business methods or for an intention that you in any event never found out about. So, all those connections between abnormal competition - which is the question we have to decide - are out of the window, I suggest.

So, is it the fact that your best argument on this long discussion about the conduct of Stagecoach is that it showed to the Commission, and should show to us, that there was no viable equilibrium at the state of play when the merger actually took place, and therefore that makes the choice of the counterfactual that you adopted inherently less irrational? Is that the point?

MR. UNTERHALTER: It is the point, and the only observation we would make is not that it is less irrational, but that it is a perfectly plausible counterfactual to adopt among others that might have been adopted. But, it does not meet the standard of irrationality.

MR. BLAIR: That is a slightly different point. The argument of the 2009 position, after all that conduct -- Why are we concerned about it? Only because that would have been an even worse counterfactual to adopt?

MR. UNTERHALTER: The reason that we are concerned about it is in trying to judge what state of affairs would result absent the merger. The simple question is: Are the market realities that arose in that eighteen month period a good proxy for what the market would look like on a stable basis going forward? The answer is, “No” for the reasons given, because of the unusual reasons. That is really what the whole debate ultimately turns on.

MR. BLAIR: Thank you.

THE CHAIRMAN: Yes. You say, “Okay. With that number of buses on these routes with this market, even if you drove a bit of the market, then no-one is going to be making any money on this”. But, you still have to decide when you are looking at the future, “Who would have blinked first? Who would have cut their capacity in order for everyone to start making money again because at the moment customers are just spread too thinly over these buses and we need to cut back the capacity?” But, you still need to make a prediction as to whose buses would ultimately be running on those routes and in what proportion. That is why you choose as that prediction, going back to the equilibrium.

MR. UNTERHALTER: Yes. That is right.

THE CHAIRMAN: I think everybody accepts - and we will hear from Mr. Thompson if he does not - that it was abnormal in the sense that it would not settle down to that number of buses serving that number of customers. That is what is abnormal about it. There is too much capacity.

MR. UNTERHALTER: That is absolutely so. Perhaps on the subject, our learned friend placed considerable emphasis on the note of the meeting of 4th December, 2007, which is under

Tab 7 in the Notice of Application. Of course, one can read this in different ways. But, I think a perfectly fair reading of what the parties are engaged upon here is that they are trying to find a way out of the wall because the proposition is raised as to how they can co-exist peacefully. So, this document is really about, “Are there terms for a truce in one form or another?” That never went away. Of course, it is part of the dynamics of a war of this kind that is unsustainable that, “Yes, is one party going to blink or are they both going to keep on losing significant amounts of money until somebody goes to the wall?”, or, “Under various game theory propositions, is there going to be some co-ordinated answer which is a new equilibrium to the problem?” All of this - and I will come back to it very briefly after the adjournment - is simply consistent with the unsustainability proposition.

Then the only question is, assuming that a merger was wholly out of the question (because that is the relevant question for the counterfactual), then the issue would be: What would the terms of the peace or the armistice then be? In the view of the Commission the armistice that would then have resulted most probably in its conception is reversion to the old equilibrium. Undoubtedly on these facts there are probably other scenarios that one could paint.

THE CHAIRMAN: But it is the building blocks which went towards that conclusion that is what we have to examine - whether those were actually of sufficient substance to support as one rational conclusion that that would be what was likely to happen.

MR. UNTERHALTER: It is a question of whether in our submission the characterisation of the period is warranted -- not so much warranted, but is rational. If that characterisation is rational, then what other benchmark do you look to? You have had an historic equilibrium that has existed which seemed to be extraordinarily durable and allowed the two companies to co-exist. That is a rational benchmark. As I say, undoubtedly one could possibly conceive of others, but that would not be the test for you.

THE CHAIRMAN: Thank you very much. We will come back at two o’clock. We will then sit In Camera briefly for you to deal with the third party material. Have you any idea how long that will take?

MR. UNTERHALTER: It will not take more than ten minutes, I would think.

(<u>Adjourned for a short time</u>)

(<u>For proceedings In Camera, see separate transcript</u>)

MR. UNTERHALTER: There are really three short topics - perhaps the last a little longer than the first two. The first concerns quality partnerships. The second concerns the offer that Stagecoach made to sell a portion of its business. Both of these considerations are relied upon Stagecoach to suggest that this is not the conduct of a firm that would be seeking to drive Preston out of the market.   We would make a number of submissions about this, and I shall do so briefly.

The first is that, again, the focus of the evidence that is marshalled around this question is around, "What effects in the market is the intervention of Stagecoach having?" - and not, "With what aim did it enter the market?" as we submitted before the short adjournment. That is not fundamentally what the Commission was required, in the scheme of its reasoning to decide upon, and it did not do so. This is just some evidence that might go to the question of: What was their aim? But, the fundamental question is: What was the effect of what they were doing?" And not, "What was the aim with which they did it?" There is some significance to that because those effects are felt quite apart from any offers that are being made in what was really a process of perhaps finding a truce in the bus wars that had broken out.

As to the specifics of the QPS, however, we would direct your attention to Appendix F of the Decision at para. 46. The relevance of this question was considered by the Commission at para. 46 of Appendix F. The following is there said:

> "Stagecoach also said it proposed a Quality Partnership to PBL. It explained to us that the rationale for the suggestion was to allow both PBL and Stagecoach to retrench and said this was evidence that Stagecoach was not seeking to force PBL to sell [the exact proposition relied upon now by Stagecoach]. We note [a director] comments, which we understand to have been provided in the context of general policy advice that Stagecoach had an aversion to [and then the next bit is confidential] registration restrictions. 'Not only do they restrict new entrants - they prevent you from expanding your services to [and then there is a quotation as to how the director of Stagecoach assessed these quality partnerships]. The quality partnership process was complex and bureaucratic. We contacted LCC to understand how far the discussions between LCC and Stagecoach had progressed. In its response, LCC indicated that while preliminary discussions had taken place, no outcome was ever determined".

Some of the context and basis for those findings and that recitation is to be found under Tab 8 of the Notice of Application. Our learned friend took you to this e-mail exchange. We would just refer you to the last portion, which is not confidential. Perhaps I could just direct you to the last two paragraphs under where it says, "It is all looking --" There is agreement to the proposition that is raised in the second last paragraph.

So, the effect is that these discussions about a QPS were being engaged, but in a very tentative way, and at least from a perspective on the part of Stagecoach where they had very little inclination towards these arrangements. Therefore, not that this is the exercise that should be engaged in, but to the extent that if one were doing a weighing of the evidence, which is not the task, with respect, that the Tribunal is faced with, but if one were, then one would more naturally think that this was fairly slight evidence in the light of the rather negative attitude that Stagecoach adopted to such arrangements.

In respect of the offer that was made for the acquisition by PBL of Stagecoach, at a point there were various discussions at various times as to whether there might be some sort of buy-out that could resolve the bus wars. Thereto, in Appendix F, there is reference to this at para. 44. There it says that,

> "The Stagecoach director told us that the former PBL director made an offer to buy Stagecoach's operation in Preston and added that he thought it was rather laughable. Stagecoach clarified that this reference to the difficulty that PBL would have in completing such a transaction, given the scale of Stagecoach's entire Preston operations relative to the size of PBL".

Now, this comment, again, is relevant to the time at which the offer was made to sell because PBL was plainly in a position where it was simply not situated to acquire in any way whatsoever. So, there is some question as to whether this offer was illusory or realistic, given that the scale of the wars was such, and the size of PBL relative to Stagecoach and its financial resources were such as to make it a difficult offer to accept in the circumstances.

THE CHAIRMAN: I think that the next paragraph is the important one. In para. 44 you are talking about PBL suggesting it could buy the whole of Stagecoach's operation, and then Stagecoach say, "Well, that is rather a big thing for you to swallow, PBL". But, then there is the offer to sell the intra-urban operations. That is potentially a serious offer. I do not know. Maybe you are saying that that was not a serious offer either.

MR. UNTERHALTER: One certainly understands that the laughable point seems to have been about the acquisition of more assets certainly.

THE CHAIRMAN: The whole of ----

MR. UNTERHALTER: The whole rather than part. But the question that arises, given that assessment – I do not want to speculate – it may be it was only the size of the assets that rendered the prospect laughable, but given where PBL had got to, and given the wars that had ensued during this period, it is not clear at all how such an offer would have been capable of being accepted by PBL at the time it was made.

So again, these are two pieces of evidence, they were certainly taken account of by the Commission, but neither of them – at least in the assessment of the Commission – seem to divert from the central issue which was: what effect had the intervention had? They had put PBL in a powerless position and that had come about as a result of the competitive process which was considered to be abnormal rival. These pieces of evidence do not change that picture, because those effects are there whatever the apparent aims of Stagecoach might have been.

If I could then turn to the last topic that we wanted to address, and that deals with the question of remedies. The challenge here is that the remedy is disproportionate and it is so largely because it is said that the reasoning under grounds 1 and 2 should not permit of so far reaching a remedy because this is, in essence, seeking to restore a position that lends no significance to what Stagecoach might have done in the 18 month period, and that is the gist of why this is said not to meet the proportionality standard.

We want to just take you through some of the relevant passages because there is a very full discussion that is set out by the Commission and we would respectfully suggest that it is not particularly helpful to seize on one or other paragraph and say: "This is some crude effort to restore a state of affairs that had long since disappeared.

The basic principle is stated in para. 10.8 of the decision, which speaks about a restorative principle and I believe our learned friend took you to that paragraph, which says:

> "In accordance with our guidelines, we would normally expect that the divestiture of a commercially viable PBL would be effective in remedying the SLC because it would re-establish the structure of the market expected in the absence of the merger and thereby restore the level of competition (actual and potential) that existed prior to the launch of [the] services."

And so it is said, is this not the kind of crude restorative remedy that simply does not take proper account of what had happened. The remedy though, as it is developed in the course of the decision shows quite considerable sensitivity to what is practically possible for the purposes of creating a viable entity that can offer a competitive rivalry to Stagecoach, and perhaps I could just take you to some of those passages so it is clear that this is not any simple crude form of restorative remedy.

At 10.21, under the heading "Divestiture of a reconfigured PBL" the following is said:

"Having found that the divestment of a subset of routes (and associated assets), but without a depot, would not be an effective remedy, and bearing in mind that PBL was partially integrated into Stagecoach and was not operating as a stand-alone business following the merger, we considered whether and, if so, how PBL could be reconfigured to reinstate the levels of potential and actual competition lost as a result of the merger that existed in the Preston area before summer 2007."

So the practical problem is that there is now substantially one firm on these routes, there has been an integration, how do we extract from this integration a sufficiently reconfigured business that would be saleable and would offer levels of competition that approximate to those levels that existed in the summer of 2007. Then the following is said:

"10.22 In making our assessment, we sought to identify the smallest, potentially viable stand-alone business that could compete successfully on an ongoing basis and that would effectively remedy the SLC."

So here is the consideration of proportionality. It is the smallest possible business, and one that is viable on a stand-alone basis, so it has to be a business that is capable of being sold and so it has got to have an attributable revenue stream that is going to make it an attractive asset to acquire as a business, and as such therefore to be able to offer sustainable levels of competition in the market, and that is the basic principle that is applied.

"Such a unit would need to include at least PBL's depot (as explained above, we considered it necessary to include a depot within any divestiture package to achieve an effective remedy) and the operator's licence … without which the new owner of PBL could not operate commercial services within Preston."

So in fact the consideration is: how do we reconfigure this in such a way as to permit commercial services to be offered, again not a radical set of proposals at all.

If I could then ask you to have regard to 10.25:

"In order to define the scope of the divestiture package, we first considered what services and assets would need to be included to minimise composition risks. As a starting point for the divestiture package, we thought that risks would be minimised if the package resembled PBL as it was configured in May 2007, as PBL had been a viable stand-alone business at that time. Nevertheless we considered whether it would be practical to define the scope of the package otherwise without creating risks or practical difficulties and we therefore examined the following:

(a) Commercial services

(b) tendered services

(c) identification and inclusion of key assets."

So again, there is always this balance between the restorative principle and creating some sensible business unit.

Then at 10.29:

"We noted that there might be practical difficulties in reversing all service changes to the extent that the relevant services no longer existed and/or had been absorbed into the existing services either at PBL or Stagecoach during the March 2009 network review."

So there were certain consequences of integration that seemed to be unavoidable and incapable of being unscrambled.

"The starting point for the process of reversing these changes would therefore be to identify comparable services currently operated by Stagecoach (i.e. from the Frenchwood depot) and restore the route registrations to PBL. We identified Stagecoach routes …"

- and they then give them.

"Using passenger numbers in May 2009, we estimated that the revised PBL market share that could be achieved by adding back these routes would be approximately [X] per cent".

THE CHAIRMAN: This paragraph is under the heading "Commercial services".

MR. UNTERHALTER: Yes.

THE CHAIRMAN: What is meant by "Commercial services"?

MR. UNTERHALTER: Not as opposed to tendered services. There are certain of the services, schools and others.

THE CHAIRMAN: So it includes the bus routes that we have been talking about.

MR. UNTERHALTER: Absolutely. And that is of particular significance because in the decision and when the market definitions are being considered, it is a question of the commercial services and it differentiates those from some of the tendered services which seem to be a different kind of market.

So that then is the consideration that is relevant. Perhaps I should just finish:

"Using passenger numbers in May 2009, we estimated that the revised PBL market share that could be achieved by adding back these routes would be approximately [X] per cent…"

- I am sorry, I mentioned a confidential number –

> "... which is lower than that enjoyed by PBL in May 2007 but higher than the share in May 2009."

So again there is not a pure principle of restoration that is applicable.

Then could I refer you to the conclusion where all of these threads are then brought together, and I will not read it all, but perhaps of particular significance is 10.44:

> "First, the level of head-to-head competition between Stagecoach and divested business would be of a similar scale to that which existed between Stagecoach Preston and PBL in May 2007.
>
> Second, while the precise operations and market shares of the two parties would not be identical to those in May 2007, we concluded that the threat of potential competition between Stagecoach Preston and the owner of the divested business would be substantially the same as that between Stagecoach Preston at PBL at that time. A divestment of a reconfigured PBL would reinstate rivalry between two operators each with extensive and coherent neighbouring networks of commercial services within and around Preston from their own large depot."

So it was trying to get effectively some kind of parity with depots and routes so as to ensure that there was significant actual and, more particularly, potential rivalry. Then in 10.46 the following is said:

> "In relation to the potential competition faced by the acquirer of the divested business, Stagecoach would continue to have both the financial means and incentive to seek to expand on the routes operated by the divested business."

In working out how this was going to work, there was no sense in which it was intended that Stagecoach should in any way be disabled from being able to contest the routes that were divested. Indeed, no doubt that was possibility among a number of that Stagecoach might consider and there was no reason to use the remedy to prevent that from taking place.

In 10.48, as I think I read earlier:

> "We did not consider that it was necessary, for our remedy to be effective, to restore precisely the same conditions of competition that prevailed in Preston before the period of abnormal competition. The aim of this remedy is to reinstate rivalry between two operators each with extensive and coherent and neighbouring networks of commercial services within and around Preston from their own large depots. Provided this could be ached – as we judge to be the case in relation to this divestiture package – we would not necessarily be concerned about the outcome that resulted in Stagecoach having a stronger presence in Preston than in 2007."

So the essential object is, let us get two companies that have got sufficient scale and depots to be able to engage in competition with each other. It need not mimic exactly what had come before.

That then is the object. Then – and I will not repeat it again – in 10.62, based on the requirement for an effective remedy. There is then set out the components of the remedy that is sought.

We would submit that if one reads these passages the effect of them is to indicate that this is not a crude remedy at all, it is one that simply tries, as I have indicated, to find a remedy that will ensure a capable rival.

In 10.64 the following is said:

> "We recognise the need to preserve some flexibility in the final configuration of the divestiture package, for example in the event that a suitable potential purchaser was identified that wished to purchase a package that was different from the package set out above. We will therefore be prepared to consider variations in the precise scope of this package during the implantation stage ..."

and so on.

THE CHAIRMAN: When you divest a route, what does that actually mean? You have got the buses and you have got the depot, but to say, "Right, we are going to tell you to divest route 11 but not necessarily route" – I do not know if there was a route 90, it is not included there. So, not physically, because it probably does not exist physically, what does it mean to say that you divest a route? It means that the purchaser then operates that route and Stagecoach cannot, does not operate that route. I am not sure how you divest a route without also requiring Stagecoach Preston not to operate that route.

MR. UNTERHALTER: I have a sense of what that the answer is, but can I just check that I have this right. (After a pause) The answer that I thought was correct seems to be confirmed, which is that what the divestment involves is that the registration of the route would now vest in the acquiring firm under the remedy. That would not prevent Stagecoach from then seeking, if it wanted to attack that route, a registration of that route to then go into competition with the entity that then had the route.

THE CHAIRMAN: The registration of the route – and we asked for a note on this which I assume is coming at some point – includes the frequency of the buses on the route and where it stops, and that kind of thing?

MR. UNTERHALTER: I am afraid I am entirely in territory beyond my competence.

THE CHAIRMAN: We did mention yesterday that it would be useful to have a bit of an idea of how this actually works.

MR. UNTERHALTER: I am told that in Appendix E there is some enlightenment on this subject.

MR. THOMPSON: We did actually diligently prepare the note and I gave a copy to the Competition Commission this morning, and I was intending to deal with it when I stood up again. It is along these lines away.

MR. UNTERHALTER: At para.8 in appendix E there is some reference to this:

> "Operators' licences do not have an expiry date but are subject to the payment annual or five yearly fees ..."

THE CHAIRMAN: Registration.

MR. UNTERHALTER: Sorry, yes, under registration in para.15:

> "Operators have to provide the Commission their Traffic Commissioner and the relevant local authorities with information about each proposed route, including its starting and finishing points, a map, the timetable (or a statement that the service interval will be 10 minutes or less) and stopping arrangements."

So it appears that that would be clearly a registration that would entail ----

THE CHAIRMAN: I see, so you register that route, and then you are saying when you divest then the registration is passed over to the new buyer, and that does not mean that Stagecoach is precluded from applying to register its own route in competition with that.

MR. UNTERHALTER: Clearly, together with the registration of the route will go the buses that have serviced that route, and so some of the capacity is transferred, but it would still be open for Stagecoach to ----

THE CHAIRMAN: Yes, but what I am trying to get a feel for is whether any particular market share can be attributed to the divested routes. You might say there may temporarily be, but it is open to be contested straight away if the registration ----

MR. UNTERHALTER: Yes, and that is precisely what is contemplated in the one paragraph to which I referred, which is that it is not going to be an inhibition upon Stagecoach contesting the very routes that are being given up under the remedy.

PROFESSOR BAIN: Mr. Unterhalter, in this area of registration I need all the help I can get. The objective, as I understand it, of the Competition Commission is to restore the degree of rivalry that was in the market in 2007.

MR. UNTERHALTER: Yes.

PROFESSOR BAIN: Did the Competition Commission consider whether there would be just as much rivalry if post-divestment there were two operators but with more equal shares of the market.

MR. UNTERHALTER: I do not believe it put the question to itself in those terms, but it is always partly, of course, a question of what, as I am afraid I keep saying, “What is the relevant market?” Of course, under the market’s definition there is a very equal position. Now, whether there could be a more intense form of rivalry by other divisions ----

PROFESSOR BAIN: Let us talk about the intra-urban segment of the market and get round that difficulty.

MR. UNTERHALTER: Yes. To answer the question directly, the Commission did not think about whether some other set of market shares might give rise to different competitive conditions which were tolerable to it.

PROFESSOR BAIN: Would there be any reason to believe that the rivalry would be less if the market shares were more even?

MR. UNTERHALTER: I am not certain that one would necessarily think there would be less rivalry with more equal market shares, but that, of course, it is not the test of proportionality. The question is to craft a remedy. If I could just complete the submission, which is this: You have to create a package that is saleable on the market.

PROFESSOR BAIN: That was going to be my second question. If Stagecoach were capable of finding a buyer for a package that left Stagecoach with a larger market share in the intra-urban segment of the market, would there be any objection to that if it provided the same degree of rivalry as in the 2007 situation?

MR. UNTERHALTER: I think the issue here is not whether there would be an objection. With respect, the real question is whether the remedy that was adopted was an irrational or totally -- was a remedy lacking in proportionality.

PROFESSOR BAIN: The issue is whether it is proportionate, and if it goes beyond what is necessary to re-establish the rivalry, and goes beyond what is necessary in order to have a saleable package, then it could be argued - I am not saying that it actually would be - that it was disproportionate.

MR. UNTERHALTER: But that would be an issue where one would have to establish what is that margin that is not being allowed that so brings it out of proportion to what is being done? Now, no-one has ever suggested that there is some particular market share that should be left with Stagecoach which would render it -- In other words, there may be other remedies that one could conceive of, but this remedy is not disproportionate because it works along principles that are perfectly fair in the sense that it is seeking to ensure adequate rivalry within the market. But, there could be other ways of achieving that.

PROFESSOR BAIN: Does one not have to establish adequate rivalry with the minimum damage to Stagecoach?

MR. UNTERHALTER: I have indicated that it is not minimum damage in the sense that no harm can be suffered to Stagecoach. Clearly, they are having to dispose of assets that they would rather hang on to presumably. So, the question is: What will serve to reintroduce rivalry into this market?

PROFESSOR BAIN: If more equal market shares would serve to reintroduce rivalry and if there was a saleable package, and if that did less damage to Stagecoach -- Maybe there are too many 'ifs' for you, but let us have them all. In that case one could argue that it was disproportionate to push them back to the 2007 position.

MR. UNTERHALTER: One would then have to posit that one has some measurement of all these 'ifs' and then show that the net result was disproportionate.

PROFESSOR BAIN: One could, for instance, try and sell a package and then if one failed then one would have to go back to something else.

MR. UNTERHALTER: I think our submission is twofold: one is that the point is not to try and determine some perfect point of optimal competition. That is not the point of the remedy. So, clearly there may be different ways, or different means, to achieve effective rivalry, but as long as the means that are chosen are proportional in the sense that it is a reasonable way of securing the object of rivalry, then no harm is done to proportionality. The burden cannot be on the Commission to determine what is the best way, and the only optimal way, of procuring ----

PROFESSOR BAIN: Were Stagecoach to argue, for example, that this was an unreasonable way of doing it, and were we to accept that argument, then one might wish to consider alternatives.

MR. UNTERHALTER: The problem is that Stagecoach has just made the sort of very high level -- Their argument is simply that you should not use the 2007 benchmark because that equilibrium is not the correct equilibrium to use. Now, that is a debate that we have had. If that argument is not accepted, then they do not have an argument to say, "Ah! But only if you had let us keep four buses, that would bring it into proportion, whereas at the moment it is not". The question of partial divestiture is considered in the remedies package and is rejected because it is not thought to give the entity that would be sold sufficient position in the market to take on Stagecoach.

PROFESSOR BAIN: But the partial divestiture that is considered in the remedy is largely the one where the depot is not included.

MR. UNTERHALTER: Yes.

PROFESSOR BAIN: If the depot has to be included then you have a type of package similar to the one that you are being proposed, but not necessarily as extensive.

MR. UNTERHALTER: That may be. But, again, on the proportionality analysis -- Proportionality is not proven or disproven by three or four routes. No-one has sought to make that case - that somehow or another the answer that is being given here is so disproportionate because Stagecoach should warrantably be able to hang on to something that was hard fought-over in the market place. The basic proposition that is raised by Stagecoach is that the benchmark is wrong.

PROFESSOR BAIN: Yes.

MR. UNTERHALTER: If that principle is not accepted, then proportionality is just another way of raising the same argument.

PROFESSOR BAIN: What I am trying to see, Mr. Unterhalter, is: Are there alternatives? Suppose we were to accept the argument that the benchmark was wrong. Suppose we were to accept the argument that there could be more than one company in the market. Then one might be looking for an alternative remedy. What I am trying to explore with you is whether the Competition Commission believes that any remedy that left Stagecoach with a larger share of the market would imply less rivalry in the market than the 2007-based remedy that you are proposing?

MR. UNTERHALTER: I do not think that it has turned its mind to it. As a matter of general principle I cannot say that it lacks sense, which is to say that Stagecoach, perhaps with more of those routes in the intra-urban market, may offer greater rivalry. It is possible. It has just never been -----

PROFESSOR BAIN: All I wanted to know was whether it implied less rivalry.

MR. UNTERHALTER: That may be so. But, it is an unexamined postulate.

THE CHAIRMAN: Would you not say you do not have to examine it if you have shown us passages where you say, “Well, we did not go back to 2007. We just went back to reversing the changes that had been made in 2009. We are not divesting market share because there is nothing to stop -- We are divesting routes, but those routes do not come with any market share, either in favour of the acquirer or in favour of Stagecoach, because once the route are divested, Stagecoach can apply to register those routes and presumably the acquirer can apply to register routes on Stagecoach’s remaining routes”. So, quite soon after the package is implemented, assuming it is implemented, there might actually be quite a shift around - we just do not know - in the shares of both the intra- and the inter-urban market.

MR. UNTERHALTER: I think fairly this remedy is not trying to play God in respect of how markets should be best configured for all purposes and for all time. That is not the point. It is simply practically trying to create a business that is capable of being sold on a stand-alone basis with a decent revenue stream that is going to be capable of offering effective rivalry to Stagecoach. That is the pragmatic ambition, and that has certain consequences. So, it cannot be partial. It comes down to certain buses and certain routes. That is the practical answer that is given.

THE CHAIRMAN: You did go on to consider behavioural non-compete obligations and reject them, I think.

MR. UNTERHALTER: The question of restrictive covenants is dealt with at 10.85 and thereafter, but I do not believe I need to go back to that.

In essence, our submission is simply that there is a very full consideration, there is a pragmatic criterion that is determined. It is one that recognises that you cannot entirely undo what has been integrated through the merger, but does try to provide a reconfigured PBL that is capable of being acquired to offer the rivalry and then the market will get to what ever equilibrium the parties wish to of the rivalry that follows. We would therefore submit that the proportionality point is not well taken, and it certainly can never amount to [Stagecoach Director]'s affection for some particular route that he thinks should be kept because he considers it to be innovative in some way or other. The fact is that it is the overall package and whether that package is proportionate or not that is the relevant consideration.

So we would ask, for those various reasons, that the application be dismissed.

MR. BLAIR May I ask you a question about remedies? I think it is intrinsic as a matter of law in your submissions that you disagree with a point in the application at para. 94 – do not turn it up – but the point is this, that you are submitting to us, under the guise of your factual submissions, that we could be in favour of you on Mr. Thompson's 4 to 7, and still go down on his 9 and 10, and vice-versa, that we could be in his favour on one set and against on the other. In other words, there is no necessary connection through the counterfactual between, as it were, ground 2 and ground 4. I think that is your position contrary to the point in the application.

MR. UNTERHALTER: It is possible that not everything about proportionality hangs on everything about ground 1, but there is interlinkage between these two grounds, particularly there is an interlinkage between ground 2 and ground 4 in this sense.

MR. BLAIR: That is the one I am interested in.

MR. UNTERHALTER: Because if you should reach the conclusion that the factual underpinnings of the unsustainable competition proposition is rational, and therefore not susceptible of review, then it is quite hard to see how the remedy that is crafted around that basic proposition of restoration would be disproportionate unless you found that there was some particular feature of it which simply did not square up to the principles that are enunciated, so it is possible that the basic framework is not reviewable, but there is some added feature of the remedy which seems to go so far as to make it disproportionate, even as against the relevant bench mark which is lawful.

But I do suspect that one is likely to flow from the other, there is going to be an overlap in the considerations because if the benchmark could not be established factually and is a rational benchmark then of course a remedy that is crafted around that benchmark might very well fail with the benchmark itself.

I am not sure if that entirely answers your question, but in essence it means substantially the work for proportionality needs to be done by considering ground 2, but we could conceive that there might still be some other factor out there, although we do not really understand that much has been made of something else that goes beyond a remedy outside the scheme of the benchmark.

MR. BLAIR: That is fine, thank you. That is postulating that you win on ground 2, but supposing you were to lose on ground 2, would you still have another day on ground 4?

MR. UNTERHALTER: I am not certain I could say that we would, because it is clear that the remedy is postulated on the benchmark that is adopted and so if the benchmark is bad then the remedy must be bad because it is fundamental to that remedy, so I am not certain that we could escape the logic of that.

THE CHAIRMAN: Yes, I think what you are saying is that if we are against you on ground 2, even though if we sent it back to you to reconsider you might actually still come to the conclusion that this is the package that needs to be put together because it is the least amount to make a viable package. Nonetheless, you would accept, as I gather, that the ground 2 findings so permeate the reasoning in fact adopted as regards the remedy that it would not make sense for the Commission to have another look at it, if that underpinning is no longer there – even if at the end of the day they came to the same conclusion.

MR. UNTERHALTER: Yes, I think we must accept that because if the benchmark is irrational then we would have to adopt a counterfactual with a rational benchmark, and whatever that rational benchmark might turn out to be will be influential in shaping the remedy that flows. So we could be opportunistic and simply say this will always be a 2:1 merger and so you will always need to install some rivalry here but we have to live with ----

THE CHAIRMAN: It may or may not turn out to be a significant point but you may want to discuss that.

MR. UNTERHALTER: We may consider it.

THE CHAIRMAN: And I will not hold you to that answer that you have given on your feet at the moment.

MR. UNTERHALTER: If we may consider the point and come back if we need to?

THE CHAIRMAN: Yes, thank you. Mr. Thompson?

MR. THOMPSON: I am grateful. Possibly I should pick up that I would take it that the same would apply in relation to ground 1, that were this to be found to have been an unlawful approach that the remedy would necessarily fall but obviously there may be some questions about how exactly either Stagecoach wishes to proceed or the CC wishes to proceed in the light of the judgment.

THE CHAIRMAN: That is a rather different question to which I think the answer is “yes”, but I do not think it is the same point ----

MR. THOMPSON: It is not the same question.

THE CHAIRMAN: -- as we were just discussing.

MR. THOMPSON: No. What I was proposing to do is first of all hand up the promised note in relation to registration, although I think probably Mr. Unterhalter has covered the main points. (<u>Same handed</u>)

THE CHAIRMAN: I do not want to take up time with this now, but could you just answer this question, does it cover the issue of whether the Traffic Commissioner, or whoever, has a discretion whether to accept registration and, if so, what the criteria are for deciding whether or not to register?

MR. THOMPSON: I think the point is dealt with first of all in para. 4.6 of the decision itself, and it says that there is no need for any approval, so it is effectively a procedural requirement rather than a substantive requirement, as I understand it, so that those procedures have to be followed.

Then the more detailed material is in Appendix E, which is referred to at para.4.2 of the decision, and which is set out here, gives more detail about how that works in practice, and in particular para.13 sets out the sort of detail that is provided. I think there is a typo, it is actually para.15 of Appendix E.

So that is the procedure in relation to registration, and probably relevant in relation to what actually happened here is the role of the Traffic Commissioner, and then paras.16 and 17 in appendix E specify how the Traffic Commissioner can regulate a variety of things, but including, in effect, unruly competition. One sees that at the top of p.106, that conditions can be imposed and it says:

> "... only when required to prevent dangerous traffic conditions, reduce severe traffic congestion or reduce noise and air pollution."

In this case there were such regulations introduced at the end of July 2007, but as it says in the note, the effect of those conditions, p.2, was not to restrict the ability of Stagecoach or PBL being able to register services, but it set out restrictions on how long it could stop a particular site, which I think had been a particular concern, that people were people were stopping on narrow bus stops effectively to ensure that the person could not pick up any people, and unseemly activities of that kind. Obviously the allegations were made on both sides, but I think the political support was for PBL and, as far as I understand it, from 30th July onwards the matter was regulated to this extent, and the allegations of unruly conduct which one finds in the decision essentially peter out by September 2007.

In so far as the period of abnormal competition is being used a portmanteau expression to suggest that this was still going on at the end of 2008, I would submit that the Tribunal should not be under misapprehension about that. The unruly sort of conditions that nobody could say could have been sustained were at the start of this period and we would say that in 2008 there was regular competition. It was simply that from PBL's point of view it was uneconomic competition in the current structure of the market, and so they either had to go bust or else they had to retrench. You have seen the contemporary document of [former PBL Director] about what he thought they should do, but in fact they did not do that and effectively they went bust.

I do not know if there are any other questions arising out that. There is a sort of commentary in the second half in relation to timing, because I think the question was asked, "How would it work in practice?" As I understand it, if you have got an existing service operating every 15 minutes and you want to enter on it then the obvious thing to do is to bring your buses in after seven or eight months so that they interweave, but obviously anybody who has been on a bus in London or in any town knows that it does not exactly work out like that, that buses bunch up, even on your own services, and where you have got competing services and the question arises as to who goes in, is it the person who should be there at a quarter past or the person who should be there at 20 past, if, in fact, it is 25 past, I think it is that type of issue that caused a lot of problems with people jumping ahead and then disputes as to who should have been there at the time. I think it was that sort of issue that the Traffic Commissioner became involved in and sought to resolve in the second half of 2007. I think that is a type of problem that is quite particular to buses, and I do not think is unique to Preston, I think it is an issue that one can see how it arises.

That is what I proposing to say on that.

By way of reply, I have obviously taken a note of Mr. Unterhalter's submissions as we have gone along, and I was proposing to deal with them sequentially as quickly as I may. That obviously should not detract from the basic point which is that the dispute between us is that we say, and we say it is really clear on the face of the decision, that the Competition Commission analysis here was retrospective and not prospective, it was entirely concerned with the position from June 2007 through until September 2008, and not concerned with what would have happened realistically on the market had this merger not gone ahead.

So far the future goes, it did not reach any clear or concluded view as to what would, in fact, have happened in the absence of the merger, despite accepting, as it now does, that Stagecoach's conduct was lawful and, we would say, rational in the light of the debate, particularly with Professor Bain, as to the rationale of entering a market at a loss in order to find a foothold in competition with a monopolist.

In so far as the Competition Commission projected issues forward at all, it did so on a highly unrealistic basis that PBL would not have retrenched in the face of competition from Stagecoach, and the tentative prospective findings in appendix H are, in fact, wholly and clearly inconsistent with the counterfactual assessed in section 8 of the Decision and Appendix J, which shows that the counterfactual was deliberately and openly retrospective.

One sees that from Appendix H, and I think, because this is really quite critical to all our reply, it is worth looking at appendix H straight away. We have looked at para.12 already and this is the Competition Commission's own assessment, para.12, at the bottom of p.160.

The finding of the Competition Commission is that:

> "... given the continuing competition with Stagecoach it was unlikely that PBL's losses and cash outflows would have lessened significantly during the alter months of 2008. We would therefore think that it was likely that PBL would eventually have been unable to meets its financial obligations."

That is clearly and plainly inconsistent with PBL, in the absence of the merger, being restored to conditions it was in May 2007. So that is a finding of the Competition Commission which is actually clearly inconsistent with its counterfactual.

Likewise, at para.37:

> "Arriva, or any other bus operator acquiring PBL, would have faced competition on all its key routes from Stagecoach and would have taken on an operation that was losing around £[X] every month. However, the presence of a relatively well-resourced competitor would have caused difficulties for Stagecoach. It was making substantial losses on its Preston intra-city operations owing to the abnormal competition between it and PBL."

Then para.40:

> "Faced with a competitor with greater financial resources than PBL, neither Stagecoach nor its new competitor would have an incentive to continue at such an abnormal level of competition. It is therefore possible that a retrenchment of services would ensue."

Those findings are quite inconsistent with the counterfactual and those are findings that the Commission actually makes about the outcome in the absence of the merger. It is for those reasons that we say that this is not simply a case of an error in relation to remedy or factual appreciation, it is a basic error of law to have looked backwards rather than forwards in assessing the causal impact of a merger and of adopting a counterfactual based on (I think what I said was) events that never happened in a world that never was. This is a clear and categorical error, it is not one that can be glossed over or changed. The reason we say that is that it is, as it were, the counterpoint of this being a judicial review, this is not a case where the Tribunal is asked to think of what it thinks the Competition Commission ought to have meant, or might have meant, it is what the Competition Commission mean and what it did say in its decision. If the Tribunal thinks that, in reality, something else would have happened in the absence of the merger and not the counterfactual as found in Appendix J or section 8 of the decision, then there is no way that the Tribunal can substitute its view of what would have happened for the view of the Competition Commission or can in some way trim or change. The Competition Commission is stuck with its decision, and its decision on its face is plainly and obviously not based on what the Competition Commission thinks would actually have happened, but is based on a hypothesis which simply excludes a number of historical events and goes right back to the middle of 2007, which flies in the face of reality in a quite fundamental sense. It is for that reason that we have put Ground 1 at the front of our case, and we continue to put Ground 1 at the front of our case.

THE CHAIRMAN: Can I just ask you one question, Mr. Thompson? If we concluded that the counterfactual that they adopted was wrong, say, but that inevitably the correct counterfactual would have involved two players on the market because they were right to discount the possibility that either PBL's assets would disappear from the market or that the only person who would be in a position to buy it would be Stagecoach -- If the counterfactual, or whatever it had been, would have been two players on the market, and now we have got one player on the market, surely we would have to say, "Well, as far as the actual outcome - namely, the finding of a substantial lessening of competition". That must stand, must it not? Your case on Ground 1 actually only has an effect in terms of leading to the quashing of the whole decision if there is a possibility that the correct counterfactual was the one that you were putting forward - namely, that PBL's assets would exit the market and there would just be Stagecoach?

MR. THOMPSON: I have taken you to three specific findings, which I would say show that the state of mind of the Competition Commission was that the actual effect in the absence of the merger - which I think Mr. Unterhalter now accepts is the right test, and which has clearly been put to him as the right test by the Tribunal -- The state of mind of the Competition Commission was in fact in the absence of the merger was that clearly Stagecoach would have stayed on the market and PBL would have gone bust. That is clearly what they found in Appendix H. But, it does not follow from that that PBL would have been sold to somebody else, or that its assets would have remained on the market. That is the point that I took you to in relation to para. 42 where the Competition Commission is unable to reach a conclusion as to whether or not the assets would have stayed on the market.

THE CHAIRMAN: I see.

MR. THOMPSON: Indeed, that was the failing firm defence which the Oft was uncertain about. They referred it to the Competition Commission and the Competition Commission remained uncertain about it, despite all its efforts to look into the past and labouring away about the costs. It did not decide the one thing it needed to decide, which is whether or not there would have been another buyer for PBL. That was really the only question it had to answer, and that was the one question it did not answer. So, it is really a fundamental problem.

The reason why it was a difficult question was not only the weak position of PBL, but also that PBL was holding a £[X] pension deficit, which meant that it was a very unattractive purchase. The only person who had sufficient value in purchasing PBL was Stagecoach, which is reflected in what actually happened. Stagecoach effectively put in a bid for £[X], but it paid £[X] because it took the pension deficit. If anybody else had taken it, the likely outcome would have been that the pension deficit would have stayed with PBL and would probably have ended up with the County Council. So, there was actually problem - not only the normal commercial problem, but there was actually a quite specific problem here which made it very difficult to assume that anybody else apart from Stagecoach would have been interested in this asset. I have no idea whether the Competition Commission went down the route it did go down, but it may be that it simply came to an impasse - that it could not make up its mind on this question and then, for some unaccountable reason, they went haring off on a completely different activity of not looking at the realistic position, but looking at the historical position eighteen months ago, thinking it did not approve of what Stagecoach had done over the previous eighteen months, and then taking that as the counterfactual, which is actually totally in the face of its own findings of fact. That is why we say this is a pretty fundamental error in the decision, and not simply a thing that can be tinkered around with at the edges.

If we then look in turn at the points -- I am afraid that some of them are of bigger significance than others. I will take them as succinctly as I may. You may recall that yesterday Mr. Unterhalter made a start, and we have the benefit of the transcript in relation to that. So, I can take it fairly specifically.   At p.72, lines 16 to 20, of the transcript Mr. Unterhalter professed himself deeply puzzled by my use of the expression ‘exiting the market’. I think that submission needs to be compared with the terms of the first quotation from the Decision which appears at p.68, lines 23 to 32, where the Commission itself talks about the character of Stagecoach’s entry into the Preston intra-urban market at lines 26 to 27, and at p.73, lines 18 to 25, where Mr. Unterhalter himself refers to the presence in the intra-urban market at line 20 and the market at line 22. So, I would say there was nothing particularly puzzling about this. In fact the same expression used at 5.81 of the Decision.

So far as the substance of it goes, which is a point which was raised by Professor Bain, by reference to para. 7.21 of the Decision, we would greatly adopt Professor Bain’s position, as I understood it, which at least on the demand side was to say that the market in this case was limited to intra-urban services in Preston, and therefore the question was: What supply was available to meet that demand? The evidence from other third parties - for example, Arriva and Go Ahead - was that there was very limited intention to enter the Preston market so long as Stagecoach and PBL were there. One finds that in Tabs 13 and 14 of the Notice of

Application for review bundle at paras. 16, 9, and 10. The importance of that is that, in my submission, the rough-and-ready figures - the 90:10 figures and the 75:25 figures that appeared in a table 1, para 13, Appendix G, showed to you in opening - do give a good approximation of what at least the actual competition was on this market at the relevant time.

The second point I wanted to address is a point which I think Mr. Unterhalter persisted in this morning - but, he certainly made the point last night at p.73, lines 26 and following of the transcript - where he indicates that there were, as he called it, 'various possibilities' as to what would have happened in the absence of the merger. In my submission that is an instance of something which is simply not acceptable for the Competition Commission in a judicial review type of situation. It is not permissible for the Competition Commission now to say that there were various possibilities. What actually happened was that the Competition Commission opted for a specific possibility - namely, that in the absence of the merger, magically Stagecoach would have exited the market or gone back to its original position, and PBL would have been restored to the position it was in May 2007. From our perspective it is not open to the Competition Commission to say, "Well, as long as there were going to be two competitors, it was all much the same". That is not the case. What actually they did was to say that the conditions of competition in the absence of the merger would have reverted to those in 2007. We are entitled to say that that was a naïve or nostalgic view, and not a realistic view that was open to the Competition Commission either under the law, or under its guidance.

The third point I wanted to mention was Professor Bain's questions yesterday at p.74 of the transcript, and I think it was again picked up today. Professor Bain picked up the point, and identified two separate dimensions, one, the competition itself, and the second, the market share and I think indicated that he accepted that the bus wars would have had to have come to an end but not necessarily with the market shares as they were in 2007.

The point I would like to make in relation to the first point is the point I made earlier that the bus wars in the abnormal, unseemly behaviour state of affairs had already ended in 2007, and it does not necessarily follow that the type of competition that was going on in 2008, where Stagecoach was gradually getting more profitable, and PBL was going down and down, that that could not have been sustained, at least on the part of Stagecoach there is nothing to suggest that that type of competition where one market entrant gradually establishes himself and exceptionally the market incumbent is unprofitable and is shown to be unprofitable and therefore exits the market, there is nothing abnormal or unrealistic about that, so I would not accept that that was necessarily something that should have been discounted.

I would also add the point that the realistic forward looking analysis would have looked not only to whether the bus wars would have continued to add to the state of the market shares, but also to the fact that PBL was imminently insolvent and that Stagecoach was the obvious buyer who was likely to see sufficient value in the business to be prepared to take on its pension deficit, that a realistic appraisal would have taken those factors into account.

The next point was the question that, madam Chairman, you raised at p.72, lines 22 to 33. I wanted to say that, as I understand it, that is essentially a forward looking approach, essentially the same as the approach that was adopted by the OFT rather than the approach that was adopted by the Competition Commission. It was essentially whether or not it was appropriate to treat PBL as a failing firm, and that picks up the point that I made at the start, that that is radically inconsistent with the approach actually adopted by the CC which was essentially backward looking and so I would not accept that CC can simply adopt that and say: "Yes, very interesting" because it is radically inconsistent with their position on my submission.

Moving on to today's events, and obviously being today and without a transcript it may be slightly more haphazard what comes out. The first point does arise from a point Professor Bain raised yesterday about whether or not this was a rational development for Stagecoach given the likelihood that if it established itself it would have a good 10 years of profitable business.

We do say that despite its vaunted expertise in the bus market, there seems to have been a point that escaped the CC, at least in its decision, in that it did not address the question of whether this was a commercially rational strategy for a market entrant, given the long term nature of bus business. On the contrary, as I think Professor Bain has already put to Mr. Unterhalter, it exclusively looked at the position on the basis of the current profitability of the business with only a very short projection forwards and without any contemplation or assumptions about how the market would have shaken down if Stagecoach had stayed on it. In my submission, that was an error of fact but redolent of the retrospective approach that the Commission took altogether, and also was an elementary error of analysis.

The next point is the 'failing firm' point. I think Mr. Unterhalter dealt with this yesterday, but also again today. You have my submission on that. I think Mr. Unterhalter rather hesitantly suggested that the 'failing firm' analysis had been rejected, whereas in my submission para. 42 of appendix H makes it quite clear that the Commission did not reach any finding on that and ss. 5 and 6 of the decision itself indicate why, that they put that counterfactual analysis aside and instead adopted their retrospective analysis based on the effects since 2007.

The next point was that Mr. Unterhalter indicated that we needed to place this in a realistic context and that our approach was narrowly focused on the law and did not allow for any flexibility. We would not accept that as a fair criticism at all of Stagecoach's approach, and I think I made that clear in opening. What we say is that although Appendix H makes a start on a realistic appraisal of what would have happened in the analysis of the merger it fails to complete it and the analysis in the decision and appendix J abstract altogether from a realistic analysis and returns to the market conditions as they were in June 2007, which is highly unrealistic and ignores the actual competition that was happening on the market and, as I think Mr. Blair put to Mr. Unterhalter earlier on today, has been now accepted by the CC as being lawful and not undertaken with the intention of driving PBL out of the market, or at least there has been no finding to that effect.

The next way in which I think Mr. Unterhalter put the case was that the competition was unsustainable. That, of course, is true in one sense in that PBL, who are an unprofitable company on the verge of insolvency could not have sustained this position, but there is nothing to suggest that Stagecoach could not have sustained its position. It may be worth reminding you that Stagecoach has a turnover of £850 million, has 7,000 vehicles, 100 depots and that these were [X] buses out of [X] buses ordered in a year, and that those buses are readily transferable to other routes if and when a matter becomes unprofitable. So Stagecoach was perfectly able to sustain its position and it is really unrealistic for the CC as its fundamental point to suggest that Stagecoach would, for some reason, have been forced back into its box had the merger not gone ahead in January 2009.

THE CHAIRMAN: You did though, once the merger had taken place, you did cut back the capacity on these routes, so that presumably they then became profitable routes for you.

MR. THOMPSON: Yes, well we were continuing to ----

THE CHAIRMAN: Yes, so that seems to indicate to me that you do accept that at the time of the merger there was too much capacity on these routes, that that number of buses running on a particular road could not be operated profitably; you were not going to grow the number of passengers sufficiently to support that number of buses an hour going up and down that particular road. You accept that?

MR. THOMPSON: Well that number of buses altogether was too many buses, but whether it was our buses that would have had to pull ----

THE CHAIRMAN: That is, I think, the point about the unsustainability, the point is that it was unsustainable in the sense that someone would have to cut back their capacity in order for anybody to start making money again on those routes.

MR. THOMPSON: But there was specific evidence from [Stagecoach Director] that he, in cases of this kind, does indeed monitor profitability closely, but as long as the trend is upwards he is prepared to stick with it, and that is exactly what he did do. So the suggestion that the insolvent company would have stuck at it and that Stagecoach would have pulled back to 2007 ----

THE CHAIRMAN: I do not think that is what they find. What they say is that someone would have had to cut back.

MR. THOMPSON: Yes, but I think the point that Professor Bain put very forcibly to Mr. Unterhalter was ----

THE CHAIRMAN: It was not going to be you.

MR. THOMPSON: No, they never considered the possibility that it might have been PBL, even though it was staring them in the face that that is what would have happened, that PBL was the one who was reeling, so why did they, first of all, not consider that question at all when they looked at the projected profitability of Stagecoach; and secondly, reach a conclusion that Stagecoach should be assumed to have vanished from the market, rather than that PBL should have retrenched. The evidence from [Stagecoach Director] was that that was they were expecting, and one can see exactly why they would be expecting that.

We then jump into the world of the law. Mr. Unterhalter took you to para.86 of the *BSkyB* judgment. In fact, he took you to para.85, but I referred you to para.86, which is where the Commission sets out its approach. In my submission, that was an entirely conventional approach that would have led you into Appendix H and would have required you to reach a view about what would actually have happened in the absence of the merger.

Appendix J is not addressed to that issue, and Mr. Unterhalter rightly, as he did in his skeleton and his defence, makes the point that the counterfactual is not a statutory test. As we explored yesterday, our submission is that it if you pick the wrong counterfactual – i.e. one that is not based on the absence of the merger but on something else – then you will not answer the right question for the purposes of s.35(1)(b), so it then becomes an error of law.

So far as the legal test goes, I think I would simply adopt the line of questioning which was put to Mr. Unterhalter that absence of evidential support for important findings is a basis for review, and we would say that precisely what we have done in our ground two, and hopefully in our oral submissions, is to seek to identify the fact that there is remarkably little, and we would say nothing, to support the key findings that Stagecoach was acting in an irrational way, or that it must have anticipated that PBL would be driven out of the market. So we would say that the legal test is met here on a conventional basis in the light of the guidance of the Court of Appeal in *IBA*.

There was a further question from the chair this morning about whether the purpose of this assessment in relation to the counterfactual was not only for the "failing firm" purposes, but also for the purposes of the remedy. I may have misunderstood the question, but we would emphasise that we would say that the real purpose of the counterfactual was in relation to the SLC issue, and we would say there was a clear error there and that the decision should be set aside on that basis.

I think I can now go quicker because I think I have probably dealt with most of these points already. In relation to profit maximisation and whether or not our approach was profit maximising, I note that I think Mr. Unterhalter accepted that documentary evidence was not necessarily required and that no adverse inferences could be based on a lack of documents. We do not feel that that is necessarily reflected in the decision, but I think I should briefly comment on the evidence of [Stagecoach Director] which was put to the Tribunal by reference to the oral hearing, which is at tab 11 of the defence bundle, p.40 and following. I would make two background points. First of all, and I think everyone would accept, this is not a trial of either [Stagecoach Director]'s or of Stagecoach's business practices. This evidence was to some extent criticised for being rather general and not giving evidence as to what [Stagecoach Director]'s actual state of mind was. I would submit that that largely reflects what he was asked. I think it is not unreasonable for him to give general answers.

I think it is worth looking at p.44 of the same material, lines 10 through to 10. There is a question about [Stagecoach Director] expected if the merger had not happened. He says at line 14:

> "What did I expect to happen in the longer term? I expected that Preston Bus would eventually have to run less frequently and I quite deliberately promoted the idea to [Former PBL Director] that we should interest the Council in a quality partnership scheme, which would stop their practice of constantly re-timing their services to be in front of ours – the good, old-fashioned, bus war syndrome – hoping that eventually they would learn to live with us and we would live with them. That is not something [Former PBL Director] wanted to hear."

In my submission, that is relevant to the state of mind of [Stagecoach Director] and complements the point that I think Professor Bain initially picked up by reference to p.40 as to what the commercials of this looked like from the perspective of Stagecoach.

I think I can take the issues of capacity reduction, passenger number reductions, shortly. Mr. Unterhalter, I think, made something of the fact that after the merger took place there was some falling back of capacity. In my submission, there is nothing surprising or abnormal about that. That simply reflects the fact that once Stagecoach had total control over the market any over-capacity, as seen, was eliminated, and that is not an indication that anything abnormal was happening, it is exactly what you would expect.

The point in relation to retrenchment, I think we have already touched on. We say it feeds into the point that the Competition Commission should have been forward looking as to what would have happened in the market if the acquisition had not gone ahead, and that is not what it did in section 8 and Appendix J to the decision.

There is some criticism made of Stagecoach in relation to the planning process and the fact that it targeted profitable routes and discounted on those routes.

In relation to the planning issue, we would not accept that there was any reasonable justification for the Commission criticising or casting doubt on the Stagecoach approach. I think one could summarise that approach by saying that in relation to established routes anyone wanting a new bus had to put in a competitive bid, but in relation to route development, new routes, that was essentially a discretionary matter for [Stagecoach Director] and was not a matter that could be dealt with by competition between different buses in the way of an established route.

THE CHAIRMAN: It was the little paragraph (e), was it not?

MR. THOMPSON: Yes, 5.12(e), we would say that was ----

THE CHAIRMAN: The point was being made that, generally speaking, the Stagecoach businesses all have to vie with each other as to who is going to get any new buses that are bought. They have to show why they get the bus, whereas this seemed to have been done in a different way, that these 25 minibuses were just bought for the expansion of the Preston services.

MR. THOMPSON: Yes. We actually have a procedural complaint about this in that the Competition Commission says, “We find this all very difficult to understand”, and at paras.115 to 117 of our skeleton we set out detailed material showing that they should not have been under misapprehension on this point because we pointed it out in the response to the provisional findings and also in a put-back paper where we state specifically:

"No revenue projections are included for other speculative service developments such as the [X], [X] and [X] Services and the [X]. Therefore, although the fact there was no remedy ... not just general practice for general bus replacement was an unusual speculative route development".

So the way that we operate in relation to new routes is consistently quite different from the way we operate in relation to existing routes, and one can see why that might be. We would not accept that there was anything abnormal or 'suspicious' about the way we operated there.

In relation to targeting routes and discounting, I think I have probably already dealt with that in my opening submissions. We say there is absolutely nothing abnormal if you are trying to break into a monopolised market about going for the routes where there are passengers and that you may have to discount in order to attract people off the existing monopolist on to your services. That will inevitably mean that you lose money until you are established. I think that is why certainly Stagecoach - and, without trespassing on any confidentiality, other competent people with experience of the market - see that this is very much a suck-it-and-see sort of exercise where you go in expecting losses and it is just a matter of how long those losses last, and how great they are, and you then have to make a judgment as to whether or not the fight will be worth the candle in the long term. We say there was nothing abnormal about that here.

Finally on this point, para. 5.47 of the Decision was referred to in relation to duplication of routes. I think Mr. Unterhalter eventually accepted that 50 was one-third of 150. I would respectfully submit that rather than supporting the Competition Commission on this issue, given that we said that we were estimating we would get approximately 25 percent of the market. The fact that we would have got one-third of the markets in which we were present where PBL operated 49 vehicles, and that PBL had a fleet of 127, which would have voted to perhaps less successful routes, is entirely consistent with the estimate of 25 percent overall. If we had got one-third of the profitable routes there is nothing inconsistent, we say, and we would have got one quarter of the whole lot, even if there was some consolidation over time to reflect the fact that we were now on the market. So, there is certainly nothing inconsistent between that evidence and our rule-of-thumb projection of where we would have ended up. I would respectfully remind the Tribunal that the evidence of [former PBL Director] in his contemporary document was that we would get 25 to 30 percent of any route we came on to was, again entirely consistent with that evidence.

I am drawing towards the end now. Mr. Unterhalter made reference to the original evidence that we put into the Competition Commission. I think somewhat mischievously he took exception to the tone of the initial submission, saying that we had said that it was compatible. I think I would accept that perhaps we put it a bit high in terms of the rhetoric, but I think what it was intended to mean was that we timed to go in-between the slots of the existing route. We did not simply go head-to-head so that the buses were arriving at the same time. Insofar as there was a problem about that, we would say that that was an issue of bedding down between the drivers, as it were, rather than any indication that we were deliberately going at a time which did not make sense. Indeed, I think in terms of registration it would not have made any sense for us to go in on that basis.

The third party evidence was obviously confidential. The only point I would make is a general point which is that Mr. Unterhalter, and the note he put in, did not in fact give any response to the point that the Decision itself is misleading at paras. 58 and 61(e) of Appendix G where certain statements are made and, in particular, the third parties supported the position that the length of time that we took was out of line with the industry norm. We would say that the Tribunal should make up its own mind as to whether that evidence was in fact consistent with the finding that appears in the Decision.

Finally, after that, in relation to the QPS, we continue to rely on the internal e-mail. I think Mr. Unterhalter said it was a weak point. The main point that seems to have been picked up by the Competition Commission was that Stagecoach had an aversion to registration restrictions. That is a restriction on registering new bus routes. We would say that the mere fact that we do not think those should be incorporated in a QPS - because they restrict competition, they restrict new entrants, and they restrict your flexibility - does not show that we were opposed to QPSs generally. I think there is evidence in the papers that we are actually party to QPSs in a number of other markets. It is not suggested, quite properly, that this is not a *bona fide* internal document.

So far as the purchase of Stagecoach's intra-urban services are concerned, Mr. Unterhalter referred to that. I would simply note that at para 45, Appendix F, the point that seems to have concerned PBL was not the commercial viability of the purchase, but legal concerns. That is confirmed by the evidence that we looked at yesterday - the manuscript note (Notice of Application for review bundle, Tab 7, p.312) - where [Former PBL Director]is quoted as saying, "No problem with funding this" and then he gives an explanation. So, he does not suggest that it was a commercial problem. Indeed, he said it was a very good offer. That is quoted by the Competition Commission in the Decision.

Finally, in relation to remedy, I think Mr. Unterhalter defended it primarily on the basis that it was quite a complicated and detailed analysis, and therefore should not be interfered with. Our complaint is not that the analysis is crude or short, but that it proceeds on a completely false basis - that the SLC flowed from the conduct of Stagecoach since June 2007. One sees that in the repeated references to the market in May 2007 (10.8, 10.21, 10.25, 1.44, 10.45, and then 10.46 to 10.48). They are all based on a remedy in relation to an SLC resulting from the period of competition since June 2007. The effect of this - although I think in argument Mr. Unterhalter suggested there was nothing to prevent Stagecoach from competing - and the whole purpose of this remedy was clearly to inhibit Stagecoach from competing on the basis that it had done over that eighteen months, even though the Competition Commission now accepts that Stagecoach's conduct had been lawful.

In relation to the two questions that were put first of all by Professor Bain and then by the Chair -- The first one, in terms of the overall proportionality: as I understand it, the effect of the remedy would be that of the 25 (28 at one point) buses that Stagecoach launched and incurred losses as an investment in entering the market in 2000 to 2008, Stagecoach would be left with a PVR (as I think it is called in the jargon) of 4 out of the 25 buses. Of course, that ties in, broadly speaking, to restoring the position back in May 2007, but not to restoring the position in the absence of the merger and so our objection is that under s.35(3) and (4) the jurisdiction of the Commission is limited to getting rid of the SLC resulting from the merger, and that it is not entitled to impose such a draconian remedy.

Then finally in relation to the point finally made that this is simply registration of routes, the one point where I would say you should look at the period of abnormal competition, look at the costs that were incurred by both parties in establishing routes by Stagecoach against PBL, even as it was, even in its inefficient state. We would say that it was quite fanciful to suggest that Stagecoach, having been put back in this way by the CC could embark on that task again against a properly capitalised and profitable company, protected by restrictive covenants and in circumstances of this case.

THE CHAIRMAN: What restrictive covenants do you say they are protected by?

MR. THOMPSON: The CC I think is prepared to give them a year's restrictive covenants and there is obviously an issue about how that would be solved. The matter is under commercial negotiation. All I am saying is it is obviously going to be a more difficult task prospectively in going against a commercial buyer than it would ----

THE CHAIRMAN: Yes, I can see that point, but I am not sure I can assume because they did reject behavioural remedies and anti-retaliation measures and that kind of thing.

MR. THOMPSON: Yes, but I do not want to end with a bad point, so ----

THE CHAIRMAN: Well, Professor Bain, do you want to ----

PROFESSOR BAIN: Well what you have said about this is not my understanding so perhaps somebody can put me right. I thought that what the CC were saying was that if you in the deal wanted to have a restrictive covenant as part of the deal in order, presumably, to get a better price, they would wear one for up to 12 months. I did not think they were saying they would impose a restrictive covenant on you, but I may have got it quite wrong.

MR. THOMPSON: There is obviously a question about how you put this and it is always dangerous to put in a flourish at the end of a long hearing, but as I understood it in a business sale, like any other business sale, the question of covenants of this kind are often in issue, but they are normally put in at the suit of the buyer rather than at the suit of the seller, and obviously there is an issue about value.

THE CHAIRMAN: Your point is that in the events that have occurred it is fanciful to suggest that Stagecoach is now going to start competing all out with whoever buys this business from them in order to regain the market share that is lost as a result of this investigation.

MR. THOMPSON: Exactly. Having battled against PBL and PBL having been shown to be essentially a form of straw man and having collapsed he then set up PBL again and envisaged that Stagecoach will embark on this project a second time. Even if that were going to happen it is clearly a pretty substantial prejudice to Stagecoach and I think it is not a point that the Tribunal needs to take into account in assessing the merits of this decision. Can I just consult if there is anything else?

THE CHAIRMAN: Yes, of course.

MR. THOMPSON: No, nothing coming from this end, so unless I can answer any questions?

THE CHAIRMAN: No, no, we have no further questions.

MR. UNTERHALTER: There is just one very small matter in respect of the most recent note that Stagecoach has put up, there are certain things that are said under para. 2 that we might want to address in a very brief note to you, if we may, because that seems to be more argumentative ----

THE CHAIRMAN: Are you talking about the note on registration and timing of services?

MR. UNTERHALTER: Yes. Well could you have a look at it, it would be good if we could have an agreed note from you, it should not be controversial this, we are just looking for a very factual discussion, so rather than have a rival note coming up it would be better to sort out the differences between you and let us have an amended agreed note between the parties. Is that possible do you think, Mr. Thompson?

MR. THOMPSON: Yes, I do not have it in soft copy form, but may be if we emailed it to Mr. Unterhalter he could mark up any changes, and we will see if we can agree it.

THE CHAIRMAN: Thank you. Thank you very much, we have certainly pressed you very hard on some points as to arguments, and you have responded extremely well and helpfully and we will let you know in due course what our decision is.