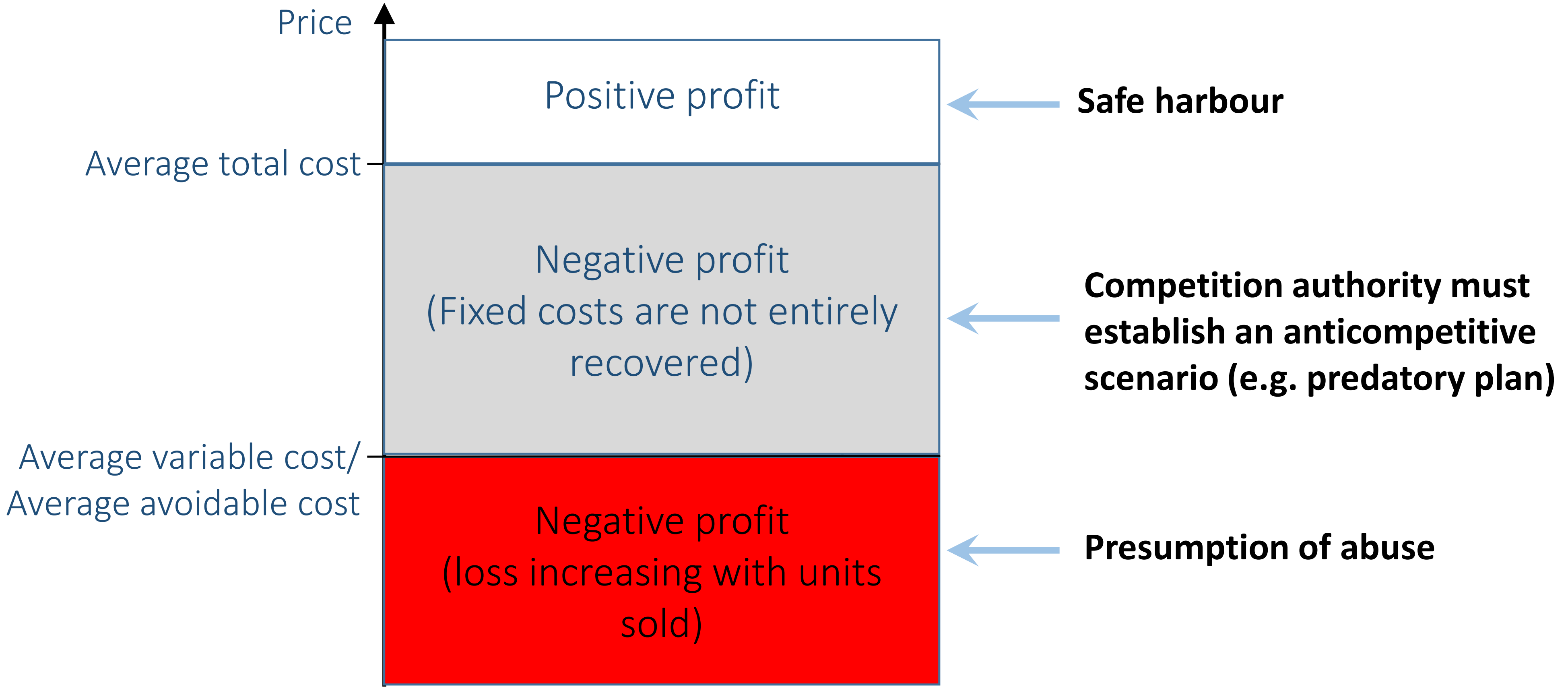
RÉPUBLIQUE FRANÇAISE

Autorité de la concurrence

Ouibus

The cost recovery test – reminder

- Transdev accused Ouibus of predation
  - A cost recovery test is usually implemented to examine such allegations



The main issue – predation in an emerging market

- The case involves an emerging market which was only liberalized recently
  - involving a dominant firm on an adjacent market – SNCF
  - the situation at the time of the complaint is not yet stabilized
    - Observed costs and demand are not necessarily representative of what the market situation will be
    - Firms are still positioning themselves to conquer the market (deploying their capacities, investments , promotions, etc.)
  - What can be the significance of a cost recovery test in such a context?
  - How to assess overcapacities? Investments in marketing? etc. in such a context

The main issue – predation in an emerging market

Case law

- The Wanadoo Interactive case in 2003 of the EC (COMP/38233)
  - Competition rules apply to sectors which are not fully mature :

    "To subordinate the application of the competition rules to a complete stabilisation of the market would be to deprive the competition authorities of the power to act in time before the abuses established have exerted their full effect and the positions unduly acquired have thus been finally consolidated." (§301)

  - The test may be adapted to the specific context
    - No cost recovery test before the market has developed sufficiently:

      "Although Wanadoo Interactive's ADSL services were launched commercially at the end of 1999, and made significant losses in 2000, the Commission takes the view that at that time the high-speed market had not yet developed sufficiently for a test of predation to be significant." (§71)

    - The cost recovery test may be subject to adjustments

      "In an expanding market, where the costs of acquiring customers form a substantial proportion of expenditure, a firm operating normally cannot set out to recover its full costs immediately." (§75)
      - Non-recurrent variable costs were spread out

The chosen approach

- Uncertainty as to which "*stage of development*" the market had reached at the time of the case
  - Was the market already sufficiently developed such that a cost recovery test (potentially subject to adjustments) is meaningful?

- Transdev alleged that Ouibus did not cover its incremental costs, which Ouibus admitted
  - No evidence that Ouibus did not recover its avoidable costs
  - The complainant did not even claim that Ouibus did not recover its avoidable costs

  → "Grey" zone

  → Other elements to consider, including analyses of the payback period
    - pursues the same underlying logic as in the Wanadoo case, i.e. can a dominant firm secure a return on its investment within a reasonable time, rather than to recover all its costs at once, without driving off market competitors with less financial capacities?
    - Allows to pay attention to the dynamics of competition, instead of taking a purely short term perspective
    - Avoids the risk of overlooking important features in an emerging and/or expanding market when adapting the cost recovery test to the specific context

The issue of disproportionate expenditures

- That approach also takes into account important marketing and promotional expenditure incurred by Ouibus
  - That expenditure is substantially higher than other competitors'
  - Part of the complaint by Transdev

- It is not for a competition authority to assess whether marketing and promotional expenditure are disproportionate or not
  - No judgement on the development model adopted by a firm
  - On a slight note,
    - these expenditures have a spillover effect - they can benefit also competitors, especially in an emerging market
    - absence of evidence showing that these investments had a potential or real effect on the market

- The chosen approach will account for the importance of these expenditures by focusing on the potential for the dominant firm to profitably recoup investments incurred within a reasonable time horizon without driving off (as efficient) competitors

Profitability assessments

- Ouibus’ business plans
  - various versions were available, due to updates in time
  - prepared for various meetings to decide on entering the market
  - Lessons from those business plans
    - Assumption 1: conquering less than 30% of market share by 2025 → no evidence that Ouibus intends to preempt the market
    - Assumption 2: cost of capital of [7-9]% → Ouibus is concerned with shareholders’ profitability
    - Assumptions on important parameters are similar to Transdev’s business plans, or less optimistic (price previsions, occupancy rates)

      → Ouibus expected/tolerated a payback period higher than its competitors (12 years)

      → Ouibus is expected to be profitable by 2019/2020, NPV is positive by the end of 2027

- The FCA undertook some simulations adopting alternative assumptions
  - key parameters (prices, number of passengers, occupancy rates): reference to market consensus + international experiences
  - results are consistent with Ouibus’ business plans

- The issue: is it rational/reasonable, for a private investor, to recoup his investments in 12 years?
  - According to Transdev, the maximum time span to recoup investments would be 3-4 years

The FCA's analysis

- Difficult to have a clear cut answer over a private investor's time horizon for recouping his investments
  - Depends on the characteristics of the market/investments
  - In sectors where risks of disruptive technological changes are likely, this time horizon may be short
  - A longer time horizon may be reasonable in a developing market characterized by strong barriers to entry
    - Domestic long distance bus transportation could be highly profitable in the long term (high EBITDA)

- Transdev's own business plans show that Transdev expected to recoup its investments in [7 – 10] years' time
  - close to Ouibus' payback period, taking into account more optimistic parameters used in Transdev's business plans

- It does not appear that Ouibus substracts itself from the profitability considerations of any private investors

An open question

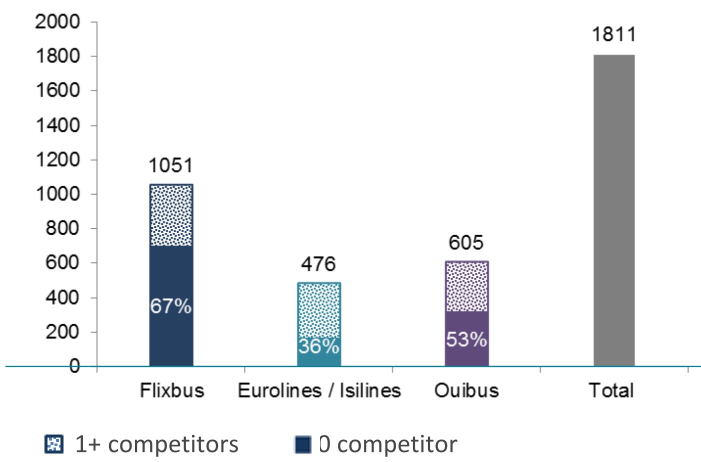
- It was possible to abstract from a standard or adjusted cost recovery test because the test would yield a “grey” zone
  - In this case, it is also likely that avoidable costs are covered
    - Avoidable costs are likely to be substantially lower compared to incremental costs
    - To attract customers, operators have to
      - offer a sufficiently high geographical coverage for their bus services
      - offer a sufficiently high frequencies of bus services

- If there were evidence that the dominant operator is unlikely to recover short term avoidable costs, would it still be possible to base the analysis on parties’ anticipatory profitability analysis?
  - If avoidable costs are not covered, will it necessarily entail exclusion of competitors?

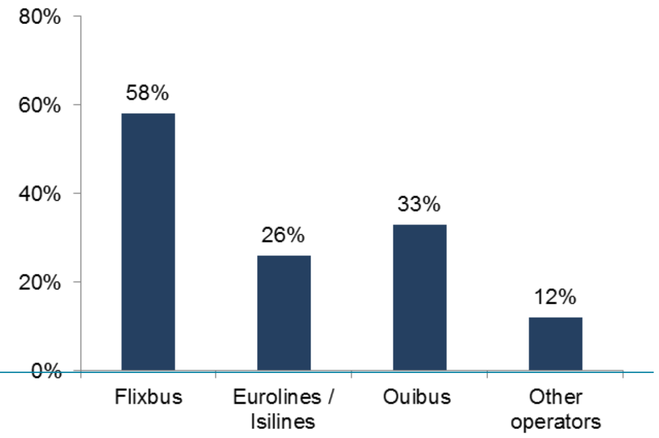
Current state of the market

- 13 active operators on the market: 3 national[1] and 10 local[2]
- Flixbus remains the market leader

Number of city-pairs and % of exclusive ones – Q2 2018



Share of the city-pairs coverage – Q2 2018



Source : ARAFER

[1]Eurolines/Isilines, Flixbus, Ouibus

[2]Actibus, DMA, Escapad'Kreol, Jacqueson, Keolis Sud Lorraine, BlaBlaCar (Car Postal, Chambon, Orain & Philippe), Migratour (seasonal activity)

No apparent effect of Ouibus' alleged practices, Transdev is still there

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Thank you for your attention!