

Anticipated acquisition by National Express Group of the Essex Thameside franchise

ME/6473/14

The Competition and Markets Authority's (CMA's) decision on reference under section 33(1) given on 15 October 2014. Full text of the decision published on 4 November 2014.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties for reasons of commercial confidentiality.

Summary

1. National Express Group (**National Express**) is a public transport provider which operates coach services throughout the UK and is the current rail operator of the Essex Thameside Franchise, which it runs under the c2c brand.
2. The Essex Thameside Franchise (the **Franchise**) is mainly a London commuter rail service which operates from Fenchurch Street station in London and along the northern Thames Gateway area of southern Essex, including Basildon, Chafford Hundred, Tilbury, Southend-on-Sea and Shoeburyness.
3. The parties overlap in the provision of public passenger transport services, including coach, bus (National Express) and rail (the Franchise). National Express's 090 coach service follows a similar route to the Franchise between Southend-on-Sea and London, stopping off at or nearby some of the Franchise stations in between. Its 350 coach service runs from Southend-on-Sea via London [see Endnote I] to Liverpool and also stops at or nearby a limited number of the Franchise stations.
4. The award of a rail franchise constitutes an acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. National Express and the Franchise will therefore cease to be distinct. The UK turnover of the Franchise exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the **Act**) is satisfied. The CMA therefore believes

that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

5. The CMA considers that there is no realistic prospect that the award of the Franchise to National Express will result in an increase in prices or a worsening of services on the Franchise as a result of the overlaps with National Express's coach services. This is due to there being a lack of any material ability or incentive for National Express to increase fares or worsen services on specific rail flows which operate at similar times to the coach services, noting that the coach services operate at much lower frequency. Furthermore, the coach services operate with lower fares and higher variable costs which in this case limits the ability and incentive of National Express to attempt to attract passengers from the Franchise on to the coach services.
6. The CMA also finds that there is no realistic prospect of the award of the Franchise leading to a worsening of the overlapping coach services operated by National Express. In regards to the short-distance flows, the limited demand and the remaining competition from overlapping bus services means that there is no incentive or ability to attract passengers from these services on to the Franchise. The CMA considers that National Express's long-distance 090 service will continue to be constrained by competitors such as Abellio Greater Anglia services, which operate similar frequencies to the Franchise services. The CMA also considers that the Franchise may not be considered a good alternative by passengers wishing to travel specifically to Victoria coach station and connect with other coach services, limiting the ability and incentive of National Express to attract passengers away from its coach services and on to the Franchise.
7. This merger will therefore not be referred under section 33(1) of the Act.

Assessment

Parties

8. National Express is a public transport provider which operates coach services throughout the UK with a network which links over 1,000 destinations. In addition, it operates UK buses mainly in the West Midlands. National Express is the current rail operator of the Franchise, which it runs under the c2c brand.
9. The Franchise is mainly a London commuter rail service which operates on the London, Tilbury and Southend Railway line. It operates from Fenchurch Street station in London and along the northern Thames Gateway area of

southern Essex, including Basildon, Chafford Hundred, Tilbury, Southend-on-Sea and Shoeburyness.

10. The Franchise was previously awarded to Prism Rail in May 1996, which was subsequently acquired by National Express in September 2000 (and rebranded as c2c in 2002). The former Franchise generated UK revenue of £143 million in the year to 31 December 2013.

Transaction

11. On 27 June 2014, the Department for Transport (**DfT**) announced that the Franchise had been awarded to National Express (the **Franchise Award**). The contract will run for 15 years from 9 November 2014 until 2029. National Express will make around £1.5 billion of payments to the DfT over the life of the franchise to operate the service.

Jurisdiction

12. The award of a rail franchise constitutes an acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. National Express and the Franchise will therefore cease to be distinct.
13. The UK turnover of the Franchise exceeds £70 million, so the turnover test in section 23(1)(b) of the Act is satisfied. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
14. The CMA received a satisfactory statutory merger notice on 18 August 2014, and the statutory deadline for a decision by the CMA is 15 October 2014.

Product frame of reference

15. The CMA considers that market definition provides a framework for assessing the competitive effects of the merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others.¹

¹ [Merger Assessment Guidelines](#) (CC2/OFT1254, September 2010), paragraph 5.2.2.

16. The parties overlap in the provision of public passenger transport services, including bus and coach (National Express) and rail (the Franchise).
17. In line with previous decisions the CMA in the present case considers, on a cautious basis, public transport as a separate product market to private transport given the limited substitutability between the two modes of transport.² Within the market for public transport there are various modes of transport (eg rail, bus, coach etc) that are available to passengers wishing to make a particular journey. The Competition Commission (**CC**) has previously noted that there are a range of factors influencing their choice, including, for example, journey time and cost and these factors may differ depending on the exact journey to be made. The CMA has in this case considered the supply of all public transport services as a starting point for the purpose of assessing the competitive effect of the Franchise Award. However the CMA notes that the precise product scope varies on a flow-by-flow basis depending on the factors described above.
18. The CC previously distinguished leisure travel from business travel and commuting due to different sensitivities in price, journey time and duration.³ This is taken into account where relevant in the CMA's competitive assessment of the present case to the extent that different ticket types (ie regulated or non-regulated) have been considered,⁴ but the CMA does not consider it necessary to conclude on whether leisure and business passengers should be considered separately given that no competition concerns arise on any basis.

Geographic frame of reference

Flow-level competition

19. As passengers travel between a specific point of origin to a specific destination, the demand is therefore for travel between two points. Consistent with previous cases the CMA assesses the impact of the transaction on a flow-by-flow basis, where a 'flow' is defined as a connection between two specific points. The CMA also considers whether nearby flows on other routes may also be in the same market to the extent that they are near enough to be substitutable from a passenger perspective.
20. In relation to overlaps between rail and coach services, the Office of Fair Trading (**OFT**) and CC have previously considered such overlaps where the

² See, for example, Competition Commission, [Review of methodologies in transport inquiries](#) (2007).

³ *ibid.*

⁴ Although the CMA notes that some passengers may switch ticket types without their journey type changing.

services connect the same two settlements as a starting point for its competitive assessment.⁵ The CMA has received no evidence to suggest deviating from this approach in the current case.

Competition for the market

21. As well as competition between operators on a flow-by-flow basis, there is in some cases competition for the right to deliver a particular service (ie competing to win a rail franchise agreement). In assessing the effects of the Franchise Award on competition for the rail franchise market, the CMA has considered a wider than flow-by-flow geographic market, including at least all rail franchise operators currently operating or recently bidding for UK rail franchises. It has not been necessary to conclude on the precise geographic market definition in respect of competition for franchises given that no competition concerns arise.

Counterfactual

22. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (that is, the counterfactual). In practice, the CMA generally adopts the pre-merger conditions of competition as the counterfactual against which to assess the impact of the merger. However, the CMA will assess the merger against an alternative counterfactual where, based on the evidence available to it, there is a realistic prospect of a counterfactual that is more competitive than the pre-merger conditions.⁶
23. In rail franchise cases, the pre-merger situation cannot be the appropriate counterfactual, as the existing rail franchise is coming to an end and a new franchise must be awarded to one of the short-listed bidders. The CMA therefore treats the appropriate counterfactual to the Franchise Award as the award of the franchise to a firm that raises no competition concerns or where any competition concerns could be remedied through undertakings in lieu of a reference to phase 2.⁷
24. This is particularly relevant in this case as National Express is the incumbent rail operator. The theory of harm generally adopted is whether the acquisition would result in a substantial lessening of competition on overlapping flows, due to the bringing together under single ownership of competing modes of public transport. In the present case, where overlaps exist, those modes of transport already are operated by a single company.

⁵ For example, see OFT, *Stagecoach / South Western* (27 February 2007), paragraph 30.

⁶ See [Merger Assessment Guidelines](#), paragraph 4.3.5 et seq.

⁷ *ibid*, paragraphs 4.3.28 and 4.3.29.

Therefore, the appropriate consideration in this case should be whether the award of the franchise significantly affects the incentives for National Express such that it leads to increases in fares or worsening of quality on the overlapping coach and Franchise services (based on the counterfactual where the Franchise was awarded to an operator with no overlapping services). The theory of harm as it applies to the different types of overlap is explained, where relevant, in more detail in the competition assessment section below.⁸

Competitive assessment

Horizontal unilateral effects

Competition for the market

25. In considering the effect on competition for the market (ie competition for rail franchises) the CMA considers that the Franchise Award does not reduce the number or identity of likely bidders for future franchises. The CMA does not therefore consider that there is a realistic prospect of a substantial lessening of competition for rail franchises as a result of the Franchise Award.

Competition on a flow-by-flow basis

Overlaps

26. National Express has two coach services that overlap with the Franchise, route 090 and route 350. The 090 service follows a similar route to the Franchise between Southend-on-Sea and London, stopping off at or nearby some of the Franchise stations in between. The 350 service runs from Southend-on-Sea via London [see Endnote I] to Liverpool and also stops at or nearby a limited number of the Franchise stations.
27. The 090 and 350 services operate once a day in each direction. National Express submits that the services exist to connect Southend-on-Sea, Basildon and the surrounding area with longer-distance coach services. In the case of the 090 service, National Express submits that its [✂] with connections on to longer-distance services via the National Express and Eurolines network (changing at London Victoria Coach Station). For example, National Express submitted that [75–85]% of passengers using the 090 service connected with another onward National Express coach service.

⁸ See OFT, Stagecoach / South Western (27 February 2007).

28. These submissions on the purposes of National Express's 090 and 350 coach services are corroborated by the breakdown of their revenues (set out in Table 1 below). This shows that [X] passengers on the 350 service are making the short-distance journeys that overlap with the Franchise, with only £[X] of National Express revenues recorded on such flows. The same is true of the 090 service, with [X] of the route's revenue being for longer journeys between London Victoria coach station and Basildon, Southend-on-Sea and surrounding areas.⁹ In addition, a significant proportion of passengers are using the 090 route as part of a longer network journey involving a change of coach at London Victoria. That is, network tickets that include the 090 service generate revenue of £[X] compared with £[X] of revenue generated from tickets that only involve travel on the 090 route.¹⁰

TABLE 1 Overview of the overlapping National Express coach services and their annual revenues

Route number	Origin	Destination	Network revenue	Total route revenue	Revenue on overlapping flows	£
090	Southend-on-Sea	London Victoria Coach Station	[X]	[X]	[X]	
350	Southend-on-Sea	Liverpool	[X]	[X]	[X] ¹¹	

29. The CMA considers whether the Franchise Award could lead to an increase in prices or worsening of services on either the overlapping coach services already operated by National Express (since customers lost as a result would switch to the Franchise) or on the Franchise (since lost customers would switch to National Express's coach services). In each case the CMA considers whether National Express has the incentive and ability to increase prices or degrade services.

Price increase or worsening of services on the coach services

30. The CMA considers below the ability and incentive for National Express to increase fares on its overlapping coach services.
31. National Express explained that fares for small flows (ie those with small revenues such as those that overlap with the Franchise) are [X]. It noted that it makes no special provision for the overlap flows and treats them as any other within the context of the National Express network due to the [X].

⁹ Only £[X] of revenue on the 090 service was from flows that did not involve travel to or from London. They were from Southend-on-Sea to Basildon, and South Benfleet to Basildon.

¹⁰ National Express also noted that the contractor operating the 090 service under National Express's name is [X]. [X], National Express submitted that the 090 service between London Victoria and Southend [X].

¹¹ South Benfleet to Hadleigh in relation to one passenger journey. This figure reflects the yield to National Express on this flow and may be below the single adult fare value since it may represent the cost of (a) a single journey of a multi-journey ticket passenger or (b) reduced-fare passengers such as concessionary fare.

32. It explained that for the 090 route, for example, fares have only been adjusted [REDACTED].¹² In relation to the 350 service, it stated that its pricing policy on this route [REDACTED]. The CMA considers in more detail long-distance and short-distance flows below.

Short-distance flows

33. The CMA understands that there is [REDACTED] for National Express's 090 and 350 services on short-distance flows (ie travel that is not to or from central London). This is evidenced by the [REDACTED].¹³ This is in line with National Express's submission that the main purpose of the routes is to offer passengers connections with longer-distance journeys.
34. The CMA considers that the award of the franchise does not materially affect the incentive for National Express to worsen its fares or services on these services (against a counterfactual where the Franchise was awarded to an operator with no overlapping services) given this limited demand. In addition, National Express submits that there is no realistic prospect of flows with [REDACTED]. Furthermore, the CMA understands that for many (although not all) of the overlap flows, there is also significant local bus competition provided by both FirstGroup and Arriva in and around the Southend-on-Sea, Basildon and Benfleet area which will continue to provide a constraint.
35. Given the above, the CMA has no competition concerns regarding an increase in fares or worsening of services in National Express's short-distance coach flows as a result of their overlaps with the Franchise.

Long-distance flows

36. The CMA has considered the overlapping flows on the long-distance services, assessing the extent to which the Franchise and National Express's coach services are close alternatives and whether third party services are a good alternative for passengers.
37. The longer-distance journeys on the 090 service are either to or from London. The overlap flow between London and Southend-on-Sea accounts for over [REDACTED]% of the revenues on the 090 route and as such is likely to be an important determinant for the passenger offer on this service. However, Abellio Greater Anglia (Abellio) runs five trains per hour during peak and three per hour during off-peak to London Liverpool Street. This is significantly

¹² National Express provided a list of price increases across its coach services in this latest review. In relation to [REDACTED]. The CMA, however, notes that in relation to several services, [REDACTED].

¹³ For example, the highest-earning short-distance flow, between Southend-on-Sea and Basildon, generated £[REDACTED] in fare revenue for 2013. See also Table 1.

higher than the 090 frequency of one service daily and as such likely to continue to exert a significant constraint on the National Express services. That is, if there was a material worsening of the National Express coach services, a significant proportion of passengers could switch to the competing Abellio services.¹⁴

38. In relation to other flows the CMA notes that [X] revenues arise from passenger travel to or from London Victoria coach station. National Express submit that this is because [X] passengers using the coach services want to travel to London Victoria coach station to connect with another coach service. For example, National Express submitted that [75–85]% of passengers using the 090 service then connected with another onward National Express coach service. The Franchise, on the other hand, runs to and from London Fenchurch Street station which may reduce the likelihood of passengers using the 090 service switching to the Franchise as a result of fare increases or worsening of services on the coach services.
39. The CMA notes that National Express did not generate any revenues on overlapping long-distance flows on its 350 service. Therefore these overlaps are unlikely to materially affect National Express's incentives.
40. The CMA therefore has no concerns regarding potential fare increases on National Express's long-distance flows on its coach services as a result of the Franchise Award.

Price increase or worsening of services on the Franchise

41. In the present case the CMA considers that there is no realistic prospect that the coach-on-rail overlaps will lead to reduced competition resulting in increases in fares or reductions in the quality of the Franchise services.
42. In relation to the quality of services of the Franchise services, the OFT and CC have in the past concluded that regulation limits the opportunity for operators to degrade quality on rail services (such as frequency or punctuality) to some extent.¹⁵
43. Further, in order to potentially gain from customers switching from the overlapping coach services to the Franchise, National Express would have to

¹⁴ National Express submits that the Abellio Greater Anglia services provide significant competition to the National Express services, particularly on the largest of the overlap flows (London–Southend). The Abellio services run broadly parallel with the Franchise services into London and are of similar frequency.

¹⁵ In its review of transport methodologies the CC noted that 'The scope to reduce services on rail franchises is also limited by regulation. In past inquiries, the CC has reached the view that there is negligible scope to reduce service levels on regulated franchises; franchise agreements often specify investments and service improvements and TOCs have to comply with a range of service quality standards.', paragraph 66.

target reductions in quality or increases in fares on specific Franchise services, which operate at similar times to the coach services which operate at a lower frequency to the Franchise services (ie once per day). The CMA considers that, particularly in light of the relatively limited overlaps between the coach and Franchise services (see paragraphs 26 to 28 above), National Express would not have the ability or incentive to perform such targeted reductions in quality or increases in fares.

44. This is particularly the case due to the lower fares¹⁶ and higher percentage variable costs¹⁷ on coach relative to rail meaning that there is limited incentive to encourage switching to overlapping coach services. National Express would generally be expected to earn a lower margin from a passenger switching from the Franchise to National Express's coach service.
45. The CMA also notes that, in terms of regulated fares (unregulated fares being subject to the constraints referred to above) the Franchise is also subject to the rail fare regulation that applies to all franchises. The government applies a regulated fares system to restrict the increases permitted on certain fares and this regulation is set out in the terms of the franchise agreement.
46. Given the lack of incentive to attract passengers away from the Franchise services and on to National Express's overlapping coach services, the CMA does not believe that the award of the Franchise to National Express gives rise to a realistic prospect of increases in fares or reductions in the quality of the Franchise services.

Conclusion on horizontal unilateral effects

47. The CMA considers that there is no realistic prospect that the Franchise Award to National Express will result in an increase in prices or a worsening of services on the Franchise as a result of the overlaps with National Express's coach services. This is due to a lack of ability or incentive for National Express to target any worsening of its competitive offering in terms of prices or services on specific flows which overlap with the coach services. In addition the CMA notes that there are lower fares and higher variable costs on coach services which limit the incentive of National Express to attempt to attract passengers from the Franchise on to the coach services.
48. The CMA also finds that there is no realistic prospect of the Franchise Award leading to a deterioration of the services on the overlapping coach services

¹⁶ By way of illustration, the mean fare revenue per journey per km of an overlap flow on the Franchise is £[REDACTED] whereas this figure is £[REDACTED] on National Express's 090 and 350 coach services (for flows where passengers use the coach).

¹⁷ This was also noted in Stagecoach / Thameslink Greater Northern (2005), paragraph 51.

operated by National Express. In regards to the short-distance flows, the limited demand and the remaining competition from overlapping bus services means that there is no incentive to attract passengers from these services on to the Franchise. The CMA considers that there is a lack of ability and incentive to attempt to attract passengers from the long-distance 090 service since the Franchise may not be seen as a good alternative by passengers wishing to travel specifically to Victoria coach station. In addition, for a large proportion of passengers travelling to London generally, there are competing rail services provided by Abellio Greater Anglia services, which operate similar frequencies to the Franchise services.

49. Accordingly, the CMA found that the Franchise Award does not give rise to a realistic prospect of a substantial lessening of competition as a result of horizontal unilateral effects.

Third party views

50. The CMA contacted relevant third parties including the DfT, TfL and competitors. No third parties raised concerns regarding the Franchise Award.
51. Third party comments have been taken into account where appropriate in the competitive assessment above.

Decision

52. Consequently, the CMA does not believe that it is or may be the case that the Franchise Award may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.
53. This merger will therefore **not be referred** under section 33(1) of the Act.

Nelson Jung

Director of Mergers

Competition and Markets Authority

15 October 2014

Endnote

- I. In regards to paragraphs 3 and 26, the CMA wishes to clarify that the 350 coach service does not operate via London. This service operates from Southend-on-Sea to Liverpool and runs parallel to the Essex Thameside Franchise only between Southend-on-Sea and Basildon in both directions. From Basildon the service operates north via Chelmsford, Stansted Airport and Cambridge to Liverpool via the Midlands.