

## Anticipated acquisition by Inter City Railways Limited of the ICEC Franchise

ME/6506/14

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. On 27 November 2014 the Department for Transport (**DfT**) announced that the InterCity East Coast rail Franchise (**ICEC** or the **ICEC Franchise**) had been awarded to Inter City Railways Limited (**ICRL**) (the **Franchise Award**), a subsidiary of Stagecoach Group plc (**Stagecoach**) and the Virgin Group Holdings Limited (**Virgin**). The ICEC Franchise is currently operated by East Coast Main Line Company Limited (**ECML**), a subsidiary of Directly Operated Railways Limited (**DOR**, which is in turn publicly owned). ICRL will acquire all of the issued share capital in ECML from DOR.
2. In this decision, ICRL, Stagecoach and ECML together are referred to as the **Parties**.<sup>1</sup>
3. The Competition and Markets Authority (**CMA**) considers that the Parties will cease to be distinct as a result of the operation of section 66(3) of the Railways Act 1993, that the turnover test is met and that accordingly arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
4. In term of its assessment of competition ‘in the market’, the CMA notes that the Parties overlap in the supply of public transport services in the UK. On a cautious basis, the CMA considers the supply of each mode of transport separately in its assessment, noting that as a starting point a service is likely to compete more closely with another service of the same mode than a service using a different mode of transport. However, the CMA recognises

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<sup>1</sup> Note that when referring to the Parties’ incentives as regards to possible action post the Franchise Award the CMA is referring to ICRL/Stagecoach only.

that the extent of competition both within and between modes of transport depends to a significant degree on the particular aspects of the journey being made. As such, the CMA has assessed the extent of competition between the Parties' services and third party transport providers on a flow-by-flow basis. The CMA has followed its decisional practice in determining whether the Parties' services overlap on a particular flow. The CMA did not have sufficient evidence to suggest that private transport, including transportation by car, is a sufficient constraint on any of the overlapping flows it considered.

5. The CMA has considered whether there is a realistic prospect that the Franchise Award will give rise to a substantial lessening of competition (SLC) in rail-on-rail, rail-on-bus and rail-on-coach overlaps between the Parties' services.
6. With regard to rail-on-rail overlaps, the CMA found that the Franchise Award gives rise to a realistic prospect of an SLC on the Peterborough–Grantham and Lincoln–Peterborough flows (given Stagecoach's East Midlands Trains operations), noting in particular that:
  - (a) the Parties are the only two train operators on these flows;
  - (b) the Parties set prices for a significant proportion of fares on these flows given the low proportion of inter-available and regulated fares, in particular on the Lincoln–Peterborough flow. The CMA therefore considers that there is price competition between the Parties on these flows which may be lost as a result of the Franchise Award;
  - (c) dedicated and inter-available fares on the Lincoln–Peterborough flow are close, which suggests that there may be close competition between the Parties and that Stagecoach may have an incentive to remove or increase dedicated fares so as to increase revenues after the Franchise Award. In addition, the CMA's analysis of the Peterborough–Grantham flow shows that Stagecoach may have an incentive to remove or significantly increase the relevant dedicated fares on the basis that this would be profitable; and
  - (d) the only other public transport operator on these flows is National Express which operates a coach service. Different modes of transport are generally not considered to be as effective a constraint as an equally independent operator of the same mode of transport. In any event, National Express only operates one service on each of these flows which the CMA does not consider sufficient to constrain the Parties on these flows.

7. With regard to rail-on-coach overlaps, the CMA found that the Franchise Award gives rise to a realistic prospect of an SLC on the Dundee–Edinburgh and Edinburgh–Aberdeen flows (given Stagecoach’s interest in the Citylink coach joint venture), noting in particular that:
  - (a) there are a number of ICEC services which may be an alternative to passengers using Citylink coach services on these flows; and
  - (b) although there are several Scotrail services and a smaller number of Cross Country services on these flows, ICEC accounts for a significant degree of industry revenue, suggesting that it may be profitable for Stagecoach to engage in a strategy to divert passengers to ICEC services, which could consist of measures designed to render Citylink services less attractive and/or competitive.
8. The CMA therefore considers that the Franchise Award gives rise to a realistic prospect of an SLC as a result of horizontal unilateral effects.
9. The CMA has also considered the possibility that the Franchise Award could result in an adverse impact on competition as a result of conglomerate effects between rail and coach operators. It has therefore assessed to what extent the Franchise Award may provide Stagecoach with the ability and incentive to weaken or foreclose competitors on its coach services by offering combined coach/bus and rail tickets limited to its own services. In summary, the CMA considers that there was insufficient evidence to suggest that there is a realistic prospect of an SLC from conglomerate effects as a result of the Franchise agreement.
10. Consistent with the CMA’s previous decisional practice relating to the assessment of rail franchise awards in assessing the Franchise Award, the CMA has also been mindful of competition ‘for’ the market, that is competition for rail franchises. Its approach to assessing competition ‘in the market’ has therefore been informed by the importance attached to the continued functioning of competition for the market. In terms of separately assessing competition for the market at a national level, the CMA considers that the Franchise Award does not reduce the number of likely bidders for future franchises and considers that the Franchise Award does not provide the Parties with an incumbency advantage that would raise concerns for future franchise awards. In summary, the CMA considers that there is no realistic prospect of an SLC for rail franchises as a result of the Franchise Award.
11. The CMA has considered whether it would be appropriate to exercise its discretion to apply the ‘markets of insufficient importance’ exception to the duty to refer (the **de minimis exception**) on the basis that the aggregate size

of the markets in relation to which the CMA has identified competition concerns could potentially lend itself to the application of this exception. However, given that the CMA found that that it is open the Parties, in principle, to offer clear-cut undertakings to address the competition concerns identified, the CMA has not considered the application of the de minimis exception to be appropriate in any event.

12. The CMA is therefore considering whether to accept undertakings under section 73 of the Enterprise Act 2002 (**the Act**). The Parties have until Friday 13 February 2015 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Franchise Award pursuant to sections 33(1) and 34ZA(2) of the Act.

## **ASSESSMENT**

### **Parties**

13. ICRL is a subsidiary of Stagecoach and Virgin established solely for the purpose of bidding for and operating the ICEC Franchise. Stagecoach has a 90% interest in ICRL through its wholly-owned subsidiary Stagecoach Transport Holdings Limited with Virgin holding the remaining 10% through its wholly-owned subsidiary, Virgin Holdings Limited (**VHL**).
14. Stagecoach is a public transport services provider which operates buses, trains, trams and coaches in the UK and abroad. Stagecoach's rail division currently operates two wholly-owned passenger franchises: the South Western Franchise, operated by South West Trains (**SWT**) which runs until February 2017 and the East Midlands Franchise operated by East Midlands Trains (**EMT**) which runs until October 2015 and, through an expected direct award to EMT or another operator (see from paragraph 24 below), until October 2017, when the DfT will re-tender this franchise. Stagecoach also holds a 49% interest in Virgin Rail Group Holdings Limited (**VRGH**), which operates the Inter City West Coast rail franchise through its (indirect) subsidiary West Coast Trains Limited (**VWC**). Virgin holds the remaining 51% of Virgin Rail Group Holdings Limited. Stagecoach operates coach services in England under the Megabus brand and combined rail/coach services under the Megabusplus brand. It also operates coach services in Scotland and between England and Scotland under the Megabus and Citylink brands through a 35% interest in the Citylink joint venture with ComfortDelGro (holding 65%). Stagecoach also operates local bus services throughout the UK.

15. Virgin is the holding company of a group of companies active in a wide range of products and services worldwide. The CMA has assessed whether Virgin's 10% interest in ICRL is sufficient to give it material influence over ICRL.<sup>2</sup> The CMA notes that [✂].<sup>3</sup> On this basis, the CMA considers that Virgin does not have material influence over ICRL and therefore, for the purposes of its merger assessment, the CMA has not considered Virgin to be a party to the present Franchise Award.
16. The ICEC Franchise comprises rail services connecting London with Yorkshire, the North East of England and Scotland, utilising the electrified East Coast Main Line between London, Peterborough, Doncaster, Leeds, York, Newcastle, Edinburgh and Glasgow. The non-electrified line extends further into Scotland to Inverness and Aberdeen, and serves Hull, Lincoln and destinations in Yorkshire. The Franchise generated UK revenue of £693.8 million in the last financial year. The ICEC Franchise commences on 1 March 2015 and will run until 31 March 2023 with a possible one-year extension.
17. The Franchise is currently operated by ECML, a subsidiary of DOR (which is in turn owned by the Department for Transport (the **DfT**)). As a part of the Franchise Award (but pursuant to a separate share sale and purchase agreement) ICRL will acquire all of the issued share capital in ECML from DOR.

## Transaction

18. On 27 November 2014 the DfT announced that the Franchise had been awarded to ICRL. ICRL will acquire all of the issued share capital in ECML from DOR.

## Jurisdiction

19. The award of a rail franchise constitutes the acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. The acquisition by ICRL of ECML will result in ICRL and the Franchise ceasing to be distinct.
20. 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

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<sup>2</sup> See *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2, January 2014), from paragraph 4.14.

<sup>3</sup> In particular clauses 5 and 6 of the Shareholders' Agreement relating to ICRL of 21 November 2014 and Article 24.4.2 of the Articles of Association of ICRL.

progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

21. The initial period for consideration of the Franchise Award under section 34ZA(3) of the Act started on 9 December 2014. On 15 December 2014 the CMA issued a notice under section 25(2) of the Act to extend the initial period because ICRL had not complied with a requirement set out in a notice under section 109 of the Act to provide certain information and documents. The current extended deadline for the CMA's decision under section 34ZA(1) of the Act is 11 February 2015.

## Counterfactual

22. The CMA considers the effect of a merger compared with the most competitive counterfactual. The CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of anticipated mergers.<sup>4</sup> However, 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 merger as the award of the franchise to a train operating company (**TOC**) that raises no competition concerns or where any competition concerns could be remedied through undertakings in lieu (**UILs**) of a reference to phase 2.<sup>5</sup> Accordingly, insofar as the operation of the Franchise is concerned, the CMA will assess the Franchise Award against a counterfactual whereby the Franchise is awarded to a TOC raising no competition concerns or where any competition concerns could be remedied through UILs.
23. The CMA has considered separately to what extent it would be appropriate to depart from the default counterfactual of prevailing conditions of competition in respect of transport services currently operated by the Parties. In general, and without evidence to the contrary, the CMA will assume that existing transport services provided by a TOC that is awarded a franchise will continue to be provided in the absence of that Franchise Award.
24. In this case, the CMA has considered whether different considerations should apply in relation to the East Midlands Franchise which is currently operated by EMT (wholly-owned by Stagecoach) and which is due to expire on

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<sup>4</sup> [Merger assessment guidelines](#), (OFT1254/CC2, September 2010), section 4.3. The merger assessment guidelines have been adopted by the CMA (see [Mergers: Guidance on the CMA's jurisdiction and procedure](#) January 2014, Annex D).

<sup>5</sup> [Merger assessment guidelines](#), paragraphs 4.3.28 - 29.

18 October 2015. According to the DfT's rail franchise schedule,<sup>6</sup> the DfT will make a direct award of this franchise prior to re-tendering it in October 2017. The CMA has corroborated this with the DfT.

25. The Parties submit that, in assessing the Franchise Award, the CMA should take no account of any potential competition concerns that may arise from EMT services competing with the Franchise. In particular, the Parties submit that there is no certainty as to whether the East Midlands rail franchise will in fact be awarded to EMT (and thus Stagecoach) by virtue of a direct award prior to October 2017. The Parties submit that the CMA would, in any event, be in a position to review separately the direct award of the East Midlands rail franchise as and when it occurs, thereby obviating the need to conduct an assessment of competition concerns arising from overlaps between EMT services and the Franchise in the context of this case.
26. As noted above, the starting point for the CMA's consideration of this question is that transport services currently provided by a TOC being awarded a franchise form part of the CMA's assessment given that the default counterfactual in anticipated mergers (such as the Franchise Award) consists of the prevailing conditions of competition. However, the CMA will adopt a different counterfactual in respect of transport services that are currently provided in circumstances where the prospect of these transport services continuing is not realistic.<sup>7</sup>
27. In examining whether it is not realistic that Stagecoach (through EMT) will continue to operate the East Midlands rail franchise beyond 18 October 2015, for instance as a result of a direct award by the DfT, the CMA notes that, to date, all direct awards of franchises have been made to the incumbent operator. The DfT has indicated to the CMA that it is in discussions with Stagecoach about the possible two-year direct award, although the DfT also indicated it may alternatively directly award the Franchise to another private rail operator or a publicly owned rail operator such as DOR.<sup>8</sup> In view of these factors, although a direct award to EMT is not certain, the CMA has not obtained compelling evidence which leads it to believe that it would be inevitable that Stagecoach would no longer operate the East Midlands rail franchise after 18 October 2015.<sup>9</sup> In any event, the CMA does not consider that the prospect of Stagecoach (through EMT) being directly awarded (and

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<sup>6</sup> See the DfT's rail franchise schedule of October 2014.

<sup>7</sup> *Merger assessment guidelines* (OFT1254/CC2), September 2010, paragraph 4.3.5.

<sup>8</sup> DfT presentation to Parliament of March 2013, [Statement of policy on the exercise of the Secretary of State's power under section 26\(1\) of the Railways Act 1993](#).

<sup>9</sup> Compare the exiting firm scenario, *Merger assessment guidelines*, paragraph 4.3.10.

therefore continuously operating the transport services on) the East Midland franchise is not realistic.

28. The CMA therefore considers that there is insufficient evidence to depart from the counterfactual of prevailing conditions of competition in respect of the rail services Stagecoach currently provides through EMT on the East Midlands rail franchise. The CMA has therefore assessed the overlaps between EMT and ICEC on the basis that the Franchise Award would result in joint ownership and that this will continue to be the case until at least October 2017.

## **Frame of reference**

29. The CMA considers that market definition provides a framework for assessing the competitive effects of a 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 merger parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.<sup>10</sup>
30. The Parties overlap in the provision of public passenger transport services, including bus (Stagecoach), coach (Stagecoach and Citylink) and rail (Stagecoach and ICEC).

## **Product scope**

### *Competition for the market*

31. As regards competition for the market, the CMA considers that the relevant product frame of reference is the award of franchises and concessions.<sup>11</sup> However, the CMA does not need to conclude since no competition concerns arise on any plausible definition of this market.

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<sup>10</sup> *Merger assessment guidelines* (OFT1254/CC2), September 2010, paragraph 5.2.2. The merger assessment guidelines were adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure*, Annex D).

<sup>11</sup> This is consistent with [Deutsche Bahn/Arriva, M.5855](#).

## *Competition in the market*

32. In line with previous decisions the CMA has in the present case considered, on a cautious basis, public transport as a separate product market to private transport given the limited demand-side substitutability.<sup>12</sup>
33. There are various modes of public transport (eg rail, bus and coach) that are available to passengers wishing to make a particular journey.<sup>13</sup> The Parties submit that there are generally separate product markets for each of rail, bus and coach services. The CMA has in this case on a cautious basis considered each mode of public transport separately. The CMA considers as a reasonable starting point that a service competes more closely with another service of the same mode of transport on a flow than with a service using a different mode of transport. However, the closeness of competition between different transport modes varies on a flow-by-flow basis given that the characteristics of passenger demand vary depending on the particular aspects of the journey being made (eg whether it is long distance, local, inter-urban etc) as well as the price of the journey.<sup>14</sup> The Competition Commission (CC) has previously noted that there are a range of factors influencing a passenger's choice of the public transport mode including journey time and price and these factors may differ depending on the exact journey to be made.<sup>15</sup> The CMA has therefore considered the constraints from both within and between modes of public transport on a flow-by-flow basis in the competitive assessment.
34. The CC previously distinguished leisure travel from business travel and commuting due to different sensitivities of the various customer groups to price, journey time and duration.<sup>16</sup> The CMA has not considered it necessary to conclude on whether there are separate product markets by customer group since this did not affect the outcome of its competitive assessment, but it has considered different sensitivities of customer groups to price, journey time and journey duration where appropriate in the competitive assessment.

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<sup>12</sup> See, for example, CC, *Review of methodologies in transport inquiries* (2007); ME/6226-13 [Completed acquisition by Arriva Passenger Services Limited of the remainder of the entire share capital of Centrebus Holdings Ltd](#), paragraph 14. The CMA also notes that the constraint from private transport (ie the car) was considered by the CC in its review and also in CC's report on the acquisition by [National Express Group Plc of the Greater Anglia Franchise](#) (2004), Appendix E, paragraph 6. However, the CC considered that there was limited substitution between public and private transport in response to price changes. It therefore did not include private transport in its market definition but, instead, considered it where relevant in its flow-by-flow assessment. In the present case the CMA does not have sufficient evidence to suggest that private transport is a constraint on any of the overlap flows considered.

<sup>13</sup> ME/2238/06 – London and South Eastern Railway/Integrated Kent Rail franchise (28 March 2006).

<sup>14</sup> The CC's report on the acquisition by [National Express Group Plc of the Greater Anglia franchise](#) (2004), paragraph 4.4.

<sup>15</sup> CC, *Review of methodologies in transport inquiries* (2007).

<sup>16</sup> CC, *Review of methodologies in transport inquiries* (2007).

## ***Geographic scope***

### *Competition for the market*

35. On a cautious basis, the CMA has considered competition for the award of rail franchises on a national basis. However, the CMA does not need to conclude since no competition concerns arise on any plausible basis.

### *Competition in the market*

36. As passengers travel between a specific point of origin to a specific point of destination (ie a point to point journey), 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.
37. The CMA uses the following definitions of overlaps in this case.

#### *Rail-on-rail overlaps*

38. The Parties identified rail-on-rail overlaps where their competing rail services served the same settlement.
39. The CMA considers that rail-on-rail overlaps could occur in the following ways:
- (a) Journeys between the same two stations (this was the approach taken by the Parties for all settlements outside of London).
  - (b) Journeys between the same two settlements, even where different stations in the same settlement are used (this was the approach taken by the Parties in regards to the London–Edinburgh flow).<sup>17</sup>
  - (c) Journeys to a main commuter city such as London from two alternative stations in nearby towns or villages.
40. The CMA has considered all such rail-on-rail overlaps in its competitive assessment.

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<sup>17</sup> See the CC's report on [National Express Group plc and the Greater Anglia franchise](#) (November 2004), paragraph 4.3.

### *Bus-on-rail overlaps*

41. The Parties applied the following criteria to identify bus-on-rail overlaps:
- (a) For flows serving inter-urban areas (either at one or both ends), bus stops and train stations were treated as overlapping where there was a distance of no more than 1200 metres between them.
  - (b) For the other flows (in more rural areas), bus stops and train stations have been treated as having the same start and end point where they serve the same settlement.
  - (c) For flows involving intra-urban travel, bus stops and train stations have been treated as overlapping where there was a distance of no more than 400 metres between them.
42. The CMA considers that, particularly given the long distance nature of ICEC, bus and rail flows should be treated as overlapping where they join the same two 'settlements'. Consistent with previous cases, it has used this approach for flows that join: two rural settlements, a commuter town or village and a large urban centre (such as London), or two settlements linked by a long-distance service (approximately 50 miles or more).<sup>18</sup>
43. For intra-urban journeys, as described in the CMA's decision in the anticipated acquisition by Govia Thameslink Limited of the Thameslink, Southern and Great Northern Rail Franchise,<sup>19</sup> data from the National Travel Survey by the DfT suggests that for bus-on-rail overlaps for short journeys in urban areas, an appropriate measure of overlap between bus stops and rail stations is 1,200 metres (where the approximate 400-metre catchment area around a bus stop abuts with the approximate 800-metre catchment area around a train station). That is, flows for which the beginning and end points are within 1,200 metres of one another are considered by the CMA to be overlapping. The CMA understands that, in the present case this is relevant only to Edinburgh.

### *Coach-on-rail overlaps*

44. The Parties, as a starting point, treated coach stops and rail stations as having the same start or end point when they served the same settlement.

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<sup>18</sup> The DfT has defined long-distance journeys using this measure. For example, see National Travel Survey 2013 (p9).

<sup>19</sup> ME/6470-14 paragraphs 28-30.

45. The Office of Fair Trading (**OFT**) and the CC have previously considered such overlaps where the services connect the same two settlements as a starting point for its competitive assessment.<sup>20</sup> The CMA has not currently received any evidence to suggest it was appropriate to deviate from this approach in the current case.

## **Competitive assessment**

### ***Competition for the market***

46. Consistent with the CMA's previous decisional practice relating to the assessment of rail franchise awards, the CMA has been mindful of the impact of the Franchise Award on 'competition for the market', that is competition for rail franchises, in conducting its review. The CMA recognises the benefits of a sufficient number of credible bidders for the DfT's rail franchise award programme which awards franchises after a competitive tender process. Overall, the CMA's approach to analysing 'competition in the market', that is between different operators of transport services, is therefore informed by the importance attached to the continued functioning of competition for the market.
47. The Parties estimate that the Franchise Award increases Stagecoach's revenue market share to 28% with an increment of 7%.<sup>21</sup>
48. The CMA considers that competition 'for the market' could be affected by the Franchise Award if it led to a reduction in the number of bidders available for future bids, or provided the Parties with an incumbency advantage relative to other bidders in future bids for franchises. The CMA considers that the Franchise Award does not reduce the number of likely bidders for future franchises, and that there are no obvious incumbency advantages gained by the Parties following this Franchise Award which would apply to future bids. The CMA therefore considers that there is no realistic prospect of an SLC for rail franchises as a result of the Franchise Award.

### ***Rail-on-rail overlaps***

#### ***Background***

49. As noted above, Stagecoach's rail division currently operates two wholly-owned passenger franchises: the South Western Franchise, operated by

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<sup>20</sup> For example, see ME/6473/14 [National Express Group/Essex Thameside](#) CMA (2014) [Stagecoach/South Western, OFT](#) (27 February 2007), paragraph 30.

<sup>21</sup> Total UK rail franchises by revenue.

South Western Trains (**SWT**) which runs until February 2017 and the East Midlands Franchise operated by EMT.

50. The East Midlands franchise is currently in revenue support with the DfT. The CMA considers whether this impacts the relevant theory of harm at paragraph 61 below.
51. In addition, given Stagecoach's significant interest in VRGH, the CMA has considered overlaps between the Franchise and the VWC services as part of its assessment of the Franchise Award (on the basis that it would recoup 49% of the profits resulting from passengers diverting from Stagecoach operated trains, buses or coaches).

#### *Horizontal unilateral effects*

52. The theory of harm the CMA is considering whether the Franchise Award could lead to an increase in prices and/or reduction in quality/service levels (including frequency of service) on either the overlapping rail services already operated by the Parties, (since customers lost as a result could switch to the Franchise) and/or on the Franchise (since lost customers could switch to the Parties' other services, including VWC). For example, if inter-available<sup>22</sup> and dedicated fares<sup>23</sup> come under the control of the same operator, there may be an incentive to either increase the dedicated fares or withdraw them. In each case the CMA has considered to what extent the Parties may have the ability and incentive to increase prices or withdraw dedicated fares and/or degrade quality/service levels, using the extent of price competition as a proxy for the extent of competition on other parameters.
53. As explained in turn below, the CMA has considered the extent to which the Parties' ability and incentive may be impacted by restrictions contained in rail regulation and the franchise agreement and the fact that EMT is currently in a programme of revenue support.

#### *Rail regulation*

54. As referred to in paragraph 52 above, the CMA considers whether the Parties have the ability and incentive to raise prices on either the ICEC Franchise or their existing rail services (all operated under DfT franchise agreements). Incentives are closely linked to the degree of existing competition between the

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<sup>22</sup> Inter-available fares can be used between a certain origin and destination on any permitted route across multiple operator services. Inter-available fares are set by the lead operator (ie the operator who has the greatest commercial interest on a certain route) and must be observed by all TOCs selling tickets for that journey or operating a service on (some or all of) the route.

<sup>23</sup> Fares set by each operator independently which are only valid on that operator's service.

Parties and ICEC making price rises attractive once that competition is removed. In regards to the ability to raise prices and in common with all rail franchises in England and Wales, the CMA considers that the Parties face restrictions on their ability to set prices on the Franchise as described below.

55. The government applies a regulated fares system to restrict the increases permitted on certain fares, the terms of which form part of the contract with each franchise operator. Historically, regulated fares fall into two 'baskets' of fares: commuter fares and other protected fares as specified.<sup>24</sup> These baskets of fares are regulated by a cap on annual fare increases. From January 2015 (only) the permitted increase in the cap on regulated fares across each basket is limited to RPI +0%. In previous years the cap was somewhat higher and TOCs were able to increase individual fares above the cap so long as the average fares across the baskets stayed below the cap but from January 2015 (only) the DfT has removed the flex on individual fares, ie the RPI +0% cap applies to all regulated fares.
56. As noted above, with the exception of the year beginning January 2015, regulation of the fare basket does not rule out more substantial fare increases across individual regulated flows.
57. Where regulated fares make up a low proportion of revenue on a flow, this can point to the operator having considerable commercial freedom to set unregulated prices on that flow. The CMA notes, however, that unregulated fares may, in certain instances, be constrained to some degree by the need to keep a reasonable relationship between regulated and unregulated fares.<sup>25</sup> Nevertheless, these considerations may mean that fare regulation alone may not be sufficient to rule out concerns over price increases.
58. Unregulated fares may be either dedicated or inter-available and include all first class fares, advance purchase fares, longer-distance standard anytime singles and returns, shorter distance off-peak returns and any new fare introduced by the franchise on the network. Where the proportion of revenue generated by inter-available fares is low compared to that generated by dedicated fares this can suggest that there is competition on price on the flow.

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<sup>24</sup> The Parties submit that the ICEC Franchise agreement specifies that the commuter fares basket includes season tickets to London from south of Newcastle, and non-London season tickets are covered by the protected fares basket. Also, anytime return tickets are regulated on the shorter journeys on non-London flows, on longer distance non-London flows the off peak return fare is regulated, and on longer distance London flows the super off peak fare is generally regulated.

<sup>25</sup> [NEG/Greater Anglia](#), Appendix C, paragraph 47.

### *Restrictions in the franchise agreement*

59. The Parties submit that their freedom to set unregulated prices is restricted by the terms of the franchise agreement to which ICRL has committed. In particular, ICRL is committed to the train service requirements (**TSRs**) which require a minimum level of frequency, journey time and stopping patterns which may impact the pricing incentives for off peak passengers. The Parties submit that unregulated fares are often available on off-peak services where there is excess capacity but which the TOC is obliged to run under the TSRs, rather than choosing to run them for a particular commercial gain. In addition, ICRL committed to a fare strategy as part of its bid. There are also monitoring systems in place to ensure that ICRL complies with the TSRs and its committed strategy.
60. The CMA notes that the Parties retain the ability and incentive to change frequencies, fares or the ticket mix in order to maximise revenues by attracting passengers from its existing overlap services.

### *EMT revenue support*

61. The CMA notes that the East Midlands franchise operated by EMT is currently in a programme of revenue support with the DfT due to it not meeting its targeted revenue. As a result, EMT receives 80% support from DfT for the shortfall (where actual revenues are less than 94% of target revenues), meaning that it is compensated for losses but also only receives 20% of any additional revenues (provided they remain below the revenue support threshold). The Parties submit that this means that they do not have any incentive to divert passengers from ICEC to EMT after the Franchise Award. While the CMA accepts that the incentive to do so is currently muted it notes that this situation may not continue with the direct award of the East Midlands franchise in October 2015 as the revenue targets may be re-negotiated. In addition, given that EMT will be compensated by the DfT for any losses accrued from passengers diverting from EMT, the CMA considers that the Parties' incentives to divert passengers from EMT to ICEC will be enhanced.

### *Filters*

62. The Parties submit that it is appropriate to use a filtering approach on the point to point overlaps identified to prioritise those flows most likely to generate possible concerns. They submit that the appropriate filters to use are as follows:
- (a) a de minimis filter, which removes overlaps that generated annual revenue of less than £20,000;

- (b) a '10% filter', which removes rail-on-bus and rail-on-coach overlaps where the revenue derived from the Stagecoach bus or coach service accounts for less than 10% of the overall route revenue; and
  - (c) an 'effective competitor filter' which:
    - (i) identifies the most relevant competitor (ie competitor offering the same mode of transport) with the most number of weekday services (ie highest frequency) in the overlapping flow; and
    - (ii) compared the frequency of the relevant competing service as identified in (i) to the frequency of the post-merger Stagecoach service. Overlap flows where the relevant competing service has a frequency lower than 50% of Stagecoach's frequency are considered more closely on the basis that that competitor would not be effective.
63. While the CMA considers that in some circumstances it may be appropriate to apply filters to prioritise the assessment of a large number of overlap flows, the CMA does not consider the use of filters to be appropriate in the present case which identified a limited number of overlap flows. In addition, since Stagecoach uses a yield management system for its rail, bus and Megabus coach services, price changes are unlikely to be prohibitively costly on flows that represent a relatively small amount of revenue. The de minimis filter used in some previous cases with a threshold of £20,000<sup>26</sup> and the 10% revenue filter might therefore exclude from further assessment flows where the Parties in this case have the financial incentive to raise prices or worsen services and, as such, are not appropriate.
64. The CMA has however not considered in detail in this decision any overlap flows where one of the Parties' overlapping services has annual revenue below £500, noting that on all such flows there are also small passenger numbers (that is, below 100 per year).
65. In relation to the effective competitor filter, the CMA considers the existence and characteristics of competitor services in its competitive assessment. In its assessment of coach-on-rail overlaps the CMA finds it appropriate to use the methodology set out at paragraph 62 to assess the effectiveness of rail competitors that are present, but has applied certain checks (set out in more detail at paragraph 180 below) given that the existence of a rail competitor

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<sup>26</sup> The filter amount has differed between cases. This figure was used in CC's report on the completed joint venture between Stagecoach Bus Holdings Limited and Braddell PLC in relation to megabus.com, Motorvator and Scottish Citylink (2006), paragraph 6.24.

that is categorised as effective (on the basis of the methodology) described above may not, in every case, be sufficient to constrain the Parties.

66. The CMA has set out in the appropriate sections below the framework used when considering each of rail-on-rail overlaps, rail-on-bus overlaps and rail-on-coach overlaps.

### ***Flow-by-flow assessment***

#### *Framework for assessment*

67. The CMA has considered the following factors in its competitive assessment of the rail-on-rail overlaps:<sup>27</sup>
- (a) Revenue increment: If the Franchise Award leads to a relatively small revenue increment on a flow it suggests that it would not lead to an SLC. The CMA has taken the revenue increment on a flow into account, alongside other evidence, as part of the competitive assessment. In addition, the CMA does not consider flows where one of the Parties' overlapping services has annual revenue below £500 any further in this decision.<sup>28</sup>
  - (b) Regulated fares: We note that regulation of the fare basket does not rule out more substantial fare increases across individual regulated flows. Where regulated fares make up a low proportion of revenue on a flow, this can point to the operator having considerable commercial freedom to set unregulated prices on that flow. The CMA takes the proportion of regulated fares on a flow into account alongside other evidence as part of the competitive assessment.
  - (c) Inter-available fares: Inter-available fares can be used between a certain origin and destination on any permitted route across multiple operator services. Inter-available fares are set by the lead operator (ie the operator who has the greatest commercial interest on a certain route) and must be observed by all TOCs selling tickets for that journey or operating a service on (some or all of) the route.

Where the proportion of revenue generated by inter-available fares is low compared to that generated by dedicated fares this can suggest that inter-

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<sup>27</sup> CC, *Review of methodologies in transport inquiries* (2007), paragraph 27; Anticipated acquisition by Virgin Group Investments Limited and Stagecoach Group plc of the Intercity East Coast Mainline franchise, December 2004 ([Stagecoach/ICEC](#) (2004)), paragraph 25.

<sup>28</sup> The CMA notes that those fares which accounted for such an amount of revenue also had passenger numbers of 100 or below.

available and dedicated fares are competing and that TOCs are also competing in the setting of dedicated fares. Post-merger, if inter-available and dedicated fares come under the control of the same operator, there may be an incentive to either increase the dedicated fares or withdraw them.

Where inter-available fares make up a high proportion of revenue on a flow, this could point to either limited price competition between the operators on that flow pre-merger, or inter-available fares being set so as to deter operators from introducing dedicated fares. For flows for which inter-available fares constitute a high proportion of revenue on a flow, the CMA has therefore also considered the incentives for operators to introduce dedicated fares on these flows. The CMA takes the proportion of inter-available fares on a flow into account alongside other evidence as part of its competitive assessment.

- (d) Comparability of the Parties' and competitors services: The CMA will compare the features of the Parties' services with each other and those of competitors present on a flow to assess the extent to which these services may be viewed as close substitutes. To assess the similarity of services, the CMA considers, where available:
- (i) frequency;
  - (ii) departure and arrival times of services (within for example peak and off-peak time bands). Particularly where there are limited numbers of ICEC services the arrival and departure times of the individual services may be a better indication of competition lost as a result of the merger rather than frequencies;
  - (iii) average journey duration; and
  - (iv) price of the main ticket type on the flow (ie the price of the most sold ticket on the flow).
- (e) Internal documents: where available the CMA considers that documents produced by the Parties and third parties in the ordinary course of business provide important insights on the level of competition on a flow.
- (f) Other evidence: The CMA has also taken account of other direct and indirect evidence provided by the Parties and third parties, including survey evidence.

### *Assessment of rail-on-rail overlaps*

68. The Parties identified 22 flows where their existing rail services overlapped with ICEC.
69. Six flows generated less than £500 for one of the Parties' services.<sup>29</sup> The CMA does not consider these flows further in this decision given that the extremely low revenue increment due to the Franchise Award means that there is no realistic prospect of an SLC arising on these flows.
70. For another nine flows<sup>30</sup> the CMA considers that, although regulated fares make up a small proportion of revenue and revenue generated from inter-available fares is at or below 90% of revenue,<sup>31</sup> there is limited existing competition on the basis of the following considerations:
- (a) A significant disparity in the numbers of services, passengers and revenue between the overlapping services; and
  - (b) The existence of third party competitors continuing to constrain the Parties after the Franchise Award.
71. The CMA therefore considers there to be no realistic prospect of competition concerns arising in regards to any of these flows.
72. In regards to the remaining seven flows the CMA considers there to be evidence suggesting that the Parties compete to some extent and has therefore set out below its assessment as to whether the Franchise Award could result in an SLC on any of these flows.

### *London–Edinburgh*

73. The Parties overlap with ICEC on London–Edinburgh on the basis of journeys between the same two cities, even where different stations in the same cities are used, in this case Edinburgh Waverley and Haymarket. There are 26/28 weekday train services (depending on the direction of travel) on this flow. Of these, 19/21 are direct ICEC services (depending on the direction of travel) and six are direct VWC services (VWC has 12 services including indirect services). A third party, Scotrail, runs one service per day (weekdays only) on this flow.

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<sup>29</sup> The CMA notes that flows with revenue increments below £500 also had very low numbers of passengers (less than 100). These flows are as follows: Doncaster–Leeds, Doncaster–Wakefield, London–Bradford, London–Hull, Peterborough–Doncaster, Peterborough–Newark.

<sup>30</sup> Doncaster–York; Haymarket–Edinburgh; London–Doncaster; London–Newark; London–Wakefield; Motherwell–Glasgow; Newark–Lincoln; Leeds–Wakefield; London–York.

<sup>31</sup> CC, *Review of methodologies in transport inquiries* (2007), paragraph 27.

74. A low proportion of revenue for both the ICEC and VWC services is from inter-available fares (less than [30–40]% for each) and regulated fares (less than [20–30]% for each) and the TOCs have introduced dedicated fares, which may indicate that there is price competition between the services which would be lost due to the Franchise Award.
75. The Parties submit that competition between the ICEC services and VWC services is limited given that there is a material disparity in the frequencies and journey durations of ICEC and VWC. The CMA considers that, although the services have similar departure times throughout the day the journey durations are dissimilar with VWC service being significantly slower than ICEC services. The CMA also notes that half of the VWC services are indirect services which may be a less attractive alternative to passengers travelling on this flow given that they tend to be of a longer duration and may be considered to be more inconvenient by passengers.
76. The CMA also considers that there is a significant disparity in the proportion of passenger journeys accounted for by VWC as compared to ICEC on this flow. VWC recently increased its services since 14 December 2013 from only one weekday service to six weekday services currently offered.<sup>32</sup> However, the Parties submit that there has been no increase in the share of journeys on this flow as shown in the table below. This was supported by internal ECML documents.<sup>33</sup>

<i>Number of VWC services</i>	<i>Period</i>	<i>ICEC journeys</i>	<i>VWC journeys</i>
1	10/11/2013 to 07/12/2013	[90–100]%	[0–10]%
6	07/12/2014 to 03/01/2015	[90–100]%	[0–10]%

77. Given the disparities in journey duration and the minimal increment in journey numbers as a result of the Franchise Award, the CMA considers that existing competition between the ICEC and VWC services on this flow is limited. However, given the low proportion of inter-available and regulated fares suggesting a degree of price competition, the CMA has also considered whether other constraints exist which will further mitigate the potential loss of competition as a result of the Franchise Award between the Parties' rail services on this particular flow.

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<sup>32</sup> The parties submit that the rationale for the recent uplift in VWC services was to provide [REDACTED].

<sup>33</sup> It is noted that the increase in frequency of the VWC service has had [REDACTED]. [REDACTED].

### *Rail services*

78. The CMA notes the presence of Scotrail on this flow. However, given that it only has one service per day, the CMA considers that it may not be seen as an alternative by passengers at other times of day and therefore will not provide a significant constraint on the Parties.

### *Coach services*

79. National Express also operates a coach service on this flow. A consideration of the degree of substitution between rail and coach is set out in more detail below. However, as referred to in paragraph 33 above, the CMA has as a starting point assumed that a different mode of transport will be less of a constraint than the same mode of transport. As such, where competition between the same modes is lost due to the Franchise Award, a threat of passengers switching to National Express may not be sufficient to mitigate or prevent any SLC arising through price increases or worsening of services on ICEC. However, given the CMA's conclusions as regards the extent of existing competition and the constraint from air services set out below it is not necessary to conclude on the degree to which the National Express services constrain the Parties on this flow.

### *Air services*

80. The Parties submit that there is a strong presence of competing air services between London and Edinburgh which exerts a material competitive constraint on the rail services on this flow. The Parties point to support for this proposition in the OFT's Stagecoach/ICEC (2004) decision<sup>34</sup> in which the Parties state that '[the OFT] found that airlines carried the vast majority of passengers on this flow and were vigorous competitors.' The CMA has considered whether the evidence available in the present case points to a similar constraint from air travel on the London–Edinburgh flow such as to mitigate the potential loss of competition as a result of the Franchise Award between the two rail services on this particular flow.
81. In support of the proposition that air services constrain rail on this flow, the Parties submit that:
- (a) There are currently 48 air services per day<sup>35</sup> between London and Edinburgh (which is significantly more than the 26/28 train services per day). Of the 48 daily flights on the flow, 25 are operated by BA, with

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<sup>34</sup> [Stagecoach/ICEC \(2004\)](#).

<sup>35</sup> This will reduce to 42 services per day (depending on the day of the week) from September 2015.

EasyJet operating ten services per day and Virgin Atlantic Airlines operating six services per day until September 2015.<sup>36</sup> There are also four FlyBe and three RyanAir services depending on the day of the week.

- (b) Air travel accounts for approximately [70–80]% of passengers on this flow, compared with [20–30]% of passengers travelling by rail and less than 1% travelling by coach.<sup>37</sup>
- (c) The air and rail fares are comparable: in relation to fares available three days in advance EasyJet single fares range from £75 to £125 and BA single fares range from £79 to £164. RyanAir single fares range between £19.99 and £82.99 depending on time of travel. For ICEC and VWC rail services, the standard advance fares range from £21 to £139 with the cheapest walk-up single fare at £125.80. Booked three days prior to travel for this flow, the advance rail fare range is £51 to £104.50 for ICEC and on VWC it ranges between £54 and £125.<sup>38</sup>
- (d) [X] suggests that [X]% of ICEC passengers travelling between London and Edinburgh had considered travelling by air.<sup>39</sup>

82. The CMA notes that air travel on this flow has considerably shorter journey times at approximately 90 minutes.<sup>40</sup> However, the CMA considers that other factors need to be included to make up the overall journey time such as travel to and from the airport, baggage collection and so on.<sup>41</sup> A [X] internal document<sup>42</sup> submitted to the CMA estimates [X]. This brings overall [X]. The journey times on ICEC and VWC remain between 20 minutes and 2 hours longer (see the table at paragraph 32 above) even with these additional factors accounted for, although the CMA acknowledges that there would have been similar differences in journey durations on the London to Glasgow flow where the OFT found competition between rail services and airlines.<sup>43</sup>
83. The Parties submitted a number of internal documents to the CMA which indicate that they monitor competition from airlines. ECML internal documents do suggest some monitoring of airlines. For example:

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<sup>36</sup> Virgin Atlantic has [announced that it will be stopping Little Red flights](#) to/from Aberdeen and Edinburgh in September 2015.

<sup>37</sup> The parties submit that approximately [0–3 million] passengers travelled by air, compared to [0–1 million] passengers travelling by rail and [0–40,000] passengers travelling by coach.

<sup>38</sup> As at 25 November 2014.

<sup>39</sup> [X]

<sup>40</sup> According to the Parties' submission.

<sup>41</sup> These factors are also relevant to the concept of the 'generalised cost' of a journey.

<sup>42</sup> Air Market Review August 2012 Further Analysis – 1306 IR.

<sup>43</sup> [Stagecoach/ICEC](#) (2004).

(a) [REDACTED]<sup>44</sup>

(b) [REDACTED]<sup>45</sup>

(c) [REDACTED]<sup>46</sup>

(d) [REDACTED]<sup>47</sup>

(e) [REDACTED]<sup>48</sup>

(f) [REDACTED]<sup>49</sup>

84. A VWC internal document states that: [REDACTED]
85. The Parties also submitted examples of ICEC marketing campaigns which were aimed specifically at attracting passengers from air services.<sup>50</sup> The CMA has also seen internal documents referring to competition from air more generally on London to Scotland flows including ECML press releases stating for example: 'The Flying Scotsman, improved First Class offer and timetable will help us to continue to grow our market share against the airlines. They represent the biggest improvements to the East Coast route for a generation and will bring more seats, more services and many faster journeys for millions of customers.'<sup>51</sup>
86. The Parties submit that the constraint from air services is recognised explicitly by the DfT. In particular, they point to the ICEC prospectus which states that 'air travel is a major competitor, particularly on long distance routes and primarily between Edinburgh, Newcastle, Leeds and London.' Additionally, according to the Parties the handbook used on request by DfT by bidders for rail franchises to prepare revenue models, the Passenger Demand Forecasting Handbook, uses the a forecast of air cost and air headway (a forecast of the frequency of competing flights) as a modal driver.
87. The high number of air services operating on this flow with not dissimilar fare price ranges (although the CMA notes that the price ranges submitted by the Parties may not include certain 'add-ons' common with air fares such as

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<sup>44</sup> Commercial Report Period 3.

<sup>45</sup> Commercial report P8.

<sup>46</sup> ECML commercial report P9.

<sup>47</sup> ECML commercial report P11.

<sup>48</sup> ECML commercial report P3.

<sup>49</sup> ECML commercial report P9.

<sup>50</sup> For example ICEC 'Why fly when you can feel at home' 2014 marketing campaign.

<sup>51</sup> <http://www.mediacentre.eastcoast.co.uk/news/release-embargoed-to-00-01-monday-23-may-2011-new-flying-scotsman-express-service-and-locomotive-29d.aspx>

luggage, taxes etc and do not include the price of the journey to the airport)<sup>52</sup> and overall journey times coupled with a significant amount of internal document evidence that the Parties monitor and react to competition from air services lead the CMA to conclude that air services provide a constraint on this flow which will continue to be present post Franchise Award.

88. Overall, the limited existing competition between the Parties and the constraint from air services leads the CMA to find that there is no realistic prospect of an SLC as a result of the Franchise Award on this flow.

### *London–Glasgow*

89. The considerations relating to this flow are similar to those set out above for the London–Edinburgh flow. ICEC has one direct service and 15 indirect services on this flow. VWC has 21 direct services, and Scotrail has one service on weekdays.
90. Low revenue from regulated and inter-available fares for ICEC and VWC indicates that the two operators have commercial freedom over prices and both have introduced dedicated fares. The CMA therefore considers that there is a degree of price competition between ICEC and VWC on this flow which may be lost as a result of the Franchise Award.
91. The Parties submit that the material disparity in frequencies of ICEC and VWC indicates that there is no pre-merger competition between ICEC and VWC on this flow and that this is supported by:
- (a) passenger numbers: VWC carried approximately [0–500,000] passengers, compared to [0–20,000] ICEC passengers. The rail passenger increment on this flow as a result of the Franchise Award would be less than [0–10]%;
  - (b) industry revenue: accounts for [80-90]% of industry revenue on this flow, compared to [0–10]% for ICEC. The Caledonian Sleeper accounts for approximately [0–10]% of industry revenue; and
  - (c) journey duration: VWC services take 275 minutes, compared to 355 minutes on ICEC service. The ICEC service is 1 hour 20 minutes slower than the VWC service.
92. The CMA considers that the minimal revenue and passenger numbers accounted for by ICEC on this flow suggests that there is limited existing

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<sup>52</sup> The CMA notes that the price differentials may mean that low cost air carriers provide a greater degree of constraint than 'traditional' air carriers.

competition between the ICEC and VWC services. However, given the potential for existing price competition, the CMA has also considered whether other constraints exist which will further mitigate the potential loss of competition between the Parties on this particular flow.

#### *Rail services*

93. The CMA notes the presence of Scotrail on this flow. However, given that it only has one service per day (which is an overnight service), the CMA considers that it will not be seen as an alternative by the vast majority of passengers currently travelling at other times of day and therefore will not exert a significant constraint on the Parties post-merger.

#### *Coach services*

94. National Express also operates a coach service on this flow. A consideration of the degree of substitution between rail and coach is set out in more detail below. However, as referred to in paragraph 33 below, the CMA has as a starting point assumed that a different mode of transport will be less of a constraint than the same mode of transport. As such, where competition between the same modes is lost due to the Franchise Award, a threat of passengers switching to National Express may not be sufficient to mitigate or prevent any SLC arising through price increases or worsening of services on ICEC. However, given the CMA's conclusions as regards the constraint from air services set out below it is not necessary to conclude on the degree to which the National Express services constrain the Parties on this flow.

#### *Air services*

95. The CMA notes that in the OFT's Stagecoach/ICEC (2004) decision the OFT found that air services were a competitive alternative to rail on this flow.
96. As with the London–Edinburgh flow, the Parties submit that there are a high number of air services available on this flow (30 compared with 23 rail services) which account for [70–80]% of total passenger journeys. The Parties submit that:
- (a) of the 30 daily flights on the flow, 18 are operated by BA, nine are operated by EasyJet and there are three Ryanair daily services (depending on the day of the week);
  - (b) the journey time on the air services between London and Glasgow is 90 minutes. This is 4 hours shorter than the journey between London and Motherwell on the ICEC service and 2 hours 40 minutes shorter than the

VWC service although the CMA notes the additional time required for the use of air services as referred to in paragraph 82 above;

- (c) approximately [0–2,500,000] passengers travelled by air to Glasgow, compared to approximately [0–600,000] passengers that travelled by rail; and
- (d) the air and rail fares are comparable: in relation to fares available three days in advance, EasyJet single fares range from £40 to £105, BA single fares range from £53 to £147 and RyanAir fares of £19.99 to £79.99. For ICEC and VWC rail services to Motherwell, the Standard Advance fares range from £22 to £139 with the cheapest walk-up single fare at £129.60 for ICEC and VWC. Booked three days prior to travel on this flow, the advance rail fare is £64.50 for ICEC, on VWC it ranges between £76.50 and £98.50.

97. The Parties have also provided some evidence of passenger numbers on air services on the London–Glasgow flow decreasing while rail passenger numbers increased on this flow (both for Virgin services and separately for other TOCs).<sup>53</sup> Although primarily this seems to indicate that air passengers may be switching to rail and as such rail may constrain air prices but not necessarily vice versa, it may indicate interaction between the two modes of transport.
98. Similar evidence from the Parties' internal documents as provided in relation to London–Edinburgh suggests that the Parties monitor and react to competition from air services on this flow. For example, one internal document stated:

Train operator East Coast today (16 March [2010]) launches a new business ticket offer in a bid to attract more corporate travellers onto rail between Scotland and London – by offering flexible First Class travel for less than the usual price of a Standard Class open ticket. On the Glasgow Central to London route, passengers can benefit from savings of 47 per cent and 31 per cent on First Class Anytime and Standard Class Anytime return rail fares respectively. Air passengers currently paying an average of £253 for flights between Edinburgh and London will also save with the new business travel package. The new ticket deal aims to further boost East Coast's Anglo-Scottish market

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<sup>53</sup> ICRL response to CMA questions of 14 January 2015. Based on the [Civil Aviation Authority's data](#) on air travel between Glasgow International and the London airports of Heathrow, Gatwick, Luton, London City and Stansted between November 2013 and October 2014.

share by stimulating extra corporate demand for rail travel on the important Edinburgh and Glasgow to London routes.

99. The high number of air services operating on this flow and overall journey times and relatively comparable prices<sup>54</sup> coupled with a significant amount of internal document evidence that the Parties monitor and react to competition from air services lead the CMA to conclude that air services provide a constraint on this flow which will continue to constrain the Parties.
100. Overall, the limited existing competition between the Parties and the constraint from air services leads the CMA to find that there is no realistic prospect of an SLC on this flow.

#### *London–Motherwell*

101. There are 5/6 weekday train services (depending on the direction of travel) on this flow. Of those, 3/4 are VWC services and there is one ICEC service. Scotrail runs a service once a night on weekdays on this flow.
102. The Parties submit that the disparities in the ICEC and VWC services on this flow demonstrates that there is limited pre-merger competition between ICEC and VWC. In particular, there are disparities in:
  - (a) journey times – the ICEC journey duration is 330 minutes, compared to VWC journey time of 250 minutes. The ICEC journey therefore takes 1 hour 20 minutes longer than the VWC journey; and
  - (b) revenue – ICEC generated £[0–160,000] of revenue, compared to £[0–700,000] VWC revenue, ie [0–20]% and around [70–80]% of industry revenue respectively.
103. The CMA considers that the limited revenue and passenger numbers accounted for by ICEC and the differing journey times on this flow suggests that there is limited pre-merger competition between the ICEC and VWC services. However, given the indications of price competition on this flow, the CMA has also considered whether other constraints exist which will mitigate the potential loss of competition between the Parties on this particular flow.

#### *Rail services*

104. The CMA notes the presence of Scotrail. However, given that it only has one service per day which is an overnight service, the CMA considers that it will

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<sup>54</sup> Although the CMA notes that there are price differentials which may mean that low cost air carriers provide a greater degree of constraint than 'traditional' air carriers.

not be seen as a sufficiently close substitute by passengers at other times of day and therefore will not exert a significant constraint over the Parties.

#### *Air services*

105. The Parties submit that air services between London and Glasgow (which is 10 miles from Motherwell) exert a strong competitive constraint on the rail services on this flow. The Parties base this on the OFT's decision in National Express/ICEC (2008) which found that air services between London and Inveness constrained rail services on the London to Aviemore flow (Aviemore being 36 miles from Inverness). The Parties submit that there are 30 air services per day between London and Glasgow, which is significantly more than the 5/6 train services between London and Motherwell. The Parties other submissions regarding the comparability between rail and air services on the London–Glasgow flow are set out above.
106. Given that, for the reasons set out above, the CMA considers that air services constrain the Parties on the London to Glasgow flow, it considers that they will similarly constrain the Parties on the London to Motherwell flow given the proximity of Motherwell to Glasgow airport.<sup>55</sup>
107. Overall, the existing limited competition between the Parties and the constraint from air services leads the CMA to find that there is no realistic prospect of an SLC on this flow.

#### *London–Leeds*

108. On this flow the parties are the only two train operators.<sup>56</sup> There are 36/34 weekday train services (depending on the direction of travel) on this flow. Of those the majority (33/32) are ICEC services and 3/2 are EMT services (depending on the direction of travel). There are also indirect trains via Sheffield on EMT trains only and requiring the passenger to change from a slow train departing London onto another EMT train also departing from London.
109. The low proportion of inter-available fares for both operators ([30–40]% for ICEC and [0–10]% for EMT) suggests that they have introduced dedicated

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<sup>55</sup> The Parties submit that the origin of approximately 7.3% of passengers using Glasgow airport that are travelling to/from London is Motherwell. The available data shows that 7.3% of passengers using Glasgow Airport are from Motherwell (532,900) and that 32.1% of passengers that use Glasgow Airport go to London. Therefore 32.1% of 532,900 is 170,820.

<sup>56</sup> National Express operates a coach service on this flow. A threat of passengers switching to National Express may not be sufficient to mitigate or prevent any SLC arising through price increases or worsening of services on ICEC. However the CMA has not find it necessary to conclude on this given that no realistic prospect of an SLC arises.

fares and that there is a degree of price competition existing on this flow. In addition, there is no other TOC operating on this flow. Both these factors suggest prima facie concerns that the Parties would have the ability and incentive to raise prices or remove dedicated fares as a result of the Franchise Award.

110. The Parties submit that the London–Leeds flow is incidental compared to EMT’s key flow on this route, London–Sheffield.<sup>57</sup> EMT runs a reduced service on London–Leeds compared to services between London and Sheffield. The Parties submit that the London–Leeds flow is operated as part of EMT’s franchise service level requirements and is also linked to its rolling stock maintenance requirements given that maintenance is carried out at Leeds station. These two considerations mean that it is worthwhile to carry passengers on a service that is required to run in any event. The Parties submit however that there is no commercial significance attached to the flow. The CMA notes in this regard that the London–Leeds flow accounts for only [X]% of EMT’s total revenue.
111. In addition, the CMA notes that EMT accounts for less than [0–10]% of total rail industry revenue and passengers on this flow. This suggests that there is limited pre-existing competition between EMT and ICEC on this flow.
112. Overall, given the very low increment indicating little, if any, existing competition the CMA does not consider there to be a realistic prospect of an SLC on this flow.
113. Although given the outcome of its competition assessment above the CMA did not need to consider any competitive constraint from air travel in the context of this flow, the parties did submit that air services do constrain their rail services. In general, the CMA considers that the same mode of transport will impose the greatest constraint on one another. Further, and without concluding on this particular flow in the current case, the CMA considers that the longer the journey distance the more likely it is that air travel will provide a strong competitive constraint on rail services.<sup>58</sup>

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<sup>57</sup> The Parties provided internal documents which they submit indicate [X]. However, the CMA cannot place any material degree of weight on the lack of reference to this flow in a limited number of internal documents.

<sup>58</sup> OFT decision in [National Express/ICEC](#) (2007), paragraph 54. The parties also submitted that air travel constrains rail travel on the London-Newcastle flow although, like Leeds-London, the CMA has not found it necessary to conclude on it.

### *London–Lincoln*

114. On this flow the parties are the only two train operators.<sup>59</sup> ICEC and EMT each operate one direct weekday service in both directions on this flow.
115. The Parties submit that [90–100]% of revenue made on rail journeys on this flow is derived from fares set by ICEC. This includes dedicated fares set by ICEC for ICEC only services, inter-available fares set by ICEC for EMT and ICEC services and ‘ICEC+Connections’ fares set by ICEC. Therefore, only [0–10]% of journeys on this flow are on dedicated fares set by EMT.<sup>60</sup>
116. The CMA considers that, given that EMT only set fares for [0–10]% of all journeys on this flow there is limited existing competition between the EMT and ICEC services which leads the CMA to conclude that there is no realistic prospect of an SLC on this flow.

### *Peterborough–Grantham*

117. On this flow the parties are the only two train operators. There are 34/33 weekday (depending on the direction of travel) train services on this flow. Of those, 20/19 are ICEC services and 14 are EMT services.
118. The Parties submit that the high level of inter-available fares on this flow ([90–100]% of ICEC revenue and [80–90]% of EMT revenue) shows that there is limited pre-merger price competition between ICEC and EMT services.
119. The CMA considers, however, that EMT sets prices for [10–20]% of fares indicating that there is currently not immaterial price competition on this flow.
120. The CMA notes that the share of rail revenue on this flow is split between ICEC [60–70]% and EMT [30–40]%. In addition, both have a similar number of services on the flow (20/19 (depending on the direction of travel) are ICEC services and 14 are EMT services). The revenue split and the similarity in service numbers suggests that both ICEC and EMT have a significant presence on this flow.
121. The Parties submit that there is a lack of incentive for the Parties to alter dedicated fares on this flow as a result of any reduced competition resulting from the Franchise Award. In support of this they have submitted a report which analyses the impact of any passenger displacement recoupment

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<sup>59</sup> National Express operates a coach service on this flow. A threat of passengers switching to National Express may not be sufficient to mitigate or prevent any SLC arising through price increases or worsening of services on ICEC. However the CMA has not found it necessary to conclude on this given that no realistic prospect of an SLC arises.

<sup>60</sup> On the ‘ICEC+Connections’ fares, ICEC are allocated [90–100]% of revenue and EMT [0–10]%.

strategy on this flow.<sup>61</sup> The analysis shows that if EMT removed or significantly increased its dedicated fares it would result in a profit increase. Whilst the CMA interprets the model with caution, given that several assumptions in the model which will impact materially upon the results obtained from it,<sup>62</sup> the CMA considers that the model supports the CMA's concern that the Parties would have the incentive to remove or significantly increase EMT dedicated fares. This is especially the case since the Parties' yield management system used to set fares reduces the cost and time of altering fares and that, the economic analysis does not account for the fact that any losses to EMT as a result of the fare increase would not fully be borne by the Parties, given that the East Midlands franchise is in revenue support (as explained further at paragraph 61 above).<sup>63</sup>

122. There are also no third party operators who could act to constrain the Parties. The only other public transport operator on this flow is National Express. The CMA notes that different modes of transport are generally not considered to be as effective a constraint as an independent operator of the same mode of transport. In any event National Express only operates one service on this flow compared to ICEC's 19 and EMT's 14. Therefore the CMA does not consider the presence of National Express to be sufficient to constrain the Parties on this flow.
123. For the reasons set out above the CMA finds that the Franchise Award gives rise to significant competition concerns on the Peterborough–Grantham flow.

#### *Lincoln–Peterborough*

124. On this flow the parties are the only two train operators. There is one direct ICEC service plus ten indirect (via Newark North Gate on ICEC and then EMT), and eight EMT services.
125. The Parties submit that given the disparity in frequencies of EMT and ICEC services (eight and one weekday service respectively), and the timing of the ICEC service (early morning (07h20) departure from Lincoln and late evening (20h00) departure from Peterborough), these ICEC services are unlikely to be considered viable alternatives to the EMT services by the majority of passengers on this flow. However, the CMA understands that ICEC also has indirect routes on this flow, which may be seen as alternatives by some

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<sup>61</sup> This modelled a 10% fare increase on rail services on this flow, estimating the number of passengers switching to ICEC taking into account ICEC's proportion of rail industry revenue.

<sup>62</sup> These assumptions include the elasticity not being flow specific, the diversion to cars and the yield used.

<sup>63</sup> The analysis provided to the CMA did not account for EMT's revenue support.

passengers (although the CMA notes that indirect journeys may be of longer duration and less convenient).

126. Notwithstanding the disparity in the number of direct services between EMT and ICEC the CMA notes that ICEC has [30–40]% of annual rail passengers, whilst EMT accounts for the remaining [60–70]% and ICEC has [40–50]% of the rail revenue on this flow, whilst EMT accounts for [50–60]%. This suggests that demand is likely not to be equally distributed across services, such that despite the disparity in the number of services both ICEC and EMT have a considerable presence on this flow.
127. There are also relatively low proportions of inter-available fares ([50–60]% ICEC and [60–70]% EMT) and regulated fares ([20–30]% EMT and [20–30]% ICEC) indicating that the Parties may be competing on price on this flow.
128. The Parties submit that, while EMT offers dedicated fares on the eight EMT services, the dedicated fare for an off peak return ticket is only around 5% less than the inter-available fare set by ICEC. Therefore, there would be no incentive to alter the fare offering on this flow as any potential commercial gain would be immaterial in the context of ICEC's operations. The CMA considers that a dedicated fare being close in price to the inter-available fare may indicate that the two fares types are competing closely, and there may be an incentive post-merger to remove the dedicated fares so as to increase revenues for the combined entity.
129. There are no third party operators which could act to constrain the Parties. The only other public transport operator on this flow is National Express. As noted in paragraph 33, the CMA notes that different modes of transport cannot be considered as effective a constraint as an independent operator of the same mode of transport. In any event National Express only operates one service on this flow. For these reasons the CMA does not consider the presence of National Express to be sufficient to constrain the Parties on this flow.
130. For the reasons set out above the CMA finds that the Franchise Award gives rise to significant competition concerns on the Lincoln – Peterborough flow.

***Rail-on-rail: competition between ICEC and West Coast Mainline and between ICEC and East Midlands***

131. Two third parties have raised concerns with the CMA that the Franchise Award may cause some prices to rise and/or quality/service levels to degrade on certain flows on the East Coast franchise line and the West Coast Mainline.

132. According to these third parties, for journeys to London from alternative stations in nearby settlements, some customers may view flows on two of the Parties services as substitutes, such that the Parties may currently compete on these flows for customers.

#### *Huddersfield–London*

133. The concerned third parties used the example of passengers living in Huddersfield and travelling to London. Part of this route could either be on ICEC from Leeds or on VWC from Manchester. Post Franchise Award Stagecoach will have an interest in both the ICEC and VWC flows.
134. The CMA has been told that around [50–60]% of interoperable revenue<sup>64</sup> for travel between London and Huddersfield is allocated to ICEC and around [30–40]% to VWC (with the remainder going to another TOC, First TransPennine), which, it has been suggested, shows that the Parties are competing for passengers travelling from Huddersfield to London.
135. The Parties submit that they set fares with regard to the wider Leeds–London and Manchester–London markets, of which passengers travelling from Huddersfield represent only a small part.
136. In support, the Parties submit that the revenue for the Huddersfield–London flow is £[0–5 million] compared to £[0–100 million] and £[0–500 million] on the Leeds–London flow and the Manchester–London flows respectively.
137. The Parties further refer to the presence of a third party rival, Grand Central, which operates some services from Brighouse and Mirfield, which are closer to Huddersfield (4.5 miles and 7 miles respectively from Huddersfield) than Manchester and Leeds. The Parties provided the CMA with a Grand Central leaflet that advertises Brighouse and Mirfield as possible stations for passengers wishing to travel from Huddersfield to London. However, the CMA notes that the constraint from Grand Central may be limited because the frequency of these Grand Central services (3/4 services per day, depending on direction of travel) is significantly lower than the frequency of the Parties' services from Leeds and Manchester. The Parties also submit that National Express provides four daily direct coach services between Huddersfield and London and would act as a constraint on the Parties.

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<sup>64</sup> The rail industry uses an algorithm known as ORCATS to allocate revenue from the sale of inter-operable tickets between the relevant operators. ORCATS uses the generalised journey time of different operators serving a route to estimate the proportion of passengers who would travel on each of the operators' services and hence the proportion of revenue from the sale of inter-operable tickets that each operator should receive.

138. The CMA considers that the revenue figures above point to only a very small proportion of revenues on the Manchester/Leeds to London flows being accounted for by passengers buying rail tickets from Huddersfield. Passengers buying Huddersfield–London tickets are, therefore, unlikely to be determinative of pricing decisions on the Leeds–London and Manchester–London flows. The CMA also understands that the price of the Huddersfield–London ticket would be bound by the price of the combination of the tickets for the Huddersfield to Leeds/Manchester and Leeds/Manchester to London flows in order to maintain price consistency across the network.
139. Further, the Parties are not able to charge different prices for passengers based on a customer’s starting location, for example for passengers from the Huddersfield area travelling to Leeds or Manchester and on to London.
140. Given the above, the CMA considers that the Franchise Award does not raise a realistic prospect of an SLC for the Huddersfield–London flow.

#### *Sheffield/Rotherham/Doncaster–London*

141. One of the two third parties also raised concerns regarding a loss of competition on certain flows between ICEC and EMT for some passengers which may result in some prices to rise and/or quality/service levels to degrade.
142. According to this third party there is a group of passengers living in the area around Sheffield, Rotherham and Doncaster who may see London–Doncaster and London–Sheffield as substitutes. The third party submitted that travelling to London from Doncaster takes around the same amount of time as travelling from Sheffield. The CMA was told that ICEC and EMT receive similar allocations of interoperable ticket revenue for journeys between London and Sheffield (either [30–40]% and [40–50]% or [30–40]% and [40–50]% depending on whether it is on a full return or reduced fare basis). The third party considered that for a group of passengers living in this part of Yorkshire the Franchise Award may give rise to competition concerns.
143. For Sheffield/Rotherham/Doncaster to London, the Parties submit that EMT customer data shows that over [80–90]% of passengers travelling between Sheffield and London on EMT live within [✂] miles of Sheffield, indicating that EMT is not transporting a material number of customers from outside of Sheffield (Rotherham being approximately 7 miles from Sheffield, and Doncaster being approximately 22 miles from Sheffield). The Parties also note that less than [0–10]% of Sheffield-London customers has a Doncaster postcode. Moreover, they submit that the Doncaster–London flow has some competition from two third party rivals in Hull Trains (seven services a day)

and Grand Central (four services per day), in addition to National Express services on all of the Sheffield/Rotherham/Doncaster–London flows.

144. The CMA considers that the passenger figures above point to only a very small proportion of passengers on the Sheffield to London flow potentially considering the Doncaster–London flow as an alternative. Further, the Parties are not able to charge different prices for passengers based on a customer's starting location, for example for passengers from the Rotherham/Doncaster area travelling to London.
145. Given the above, the CMA considers that the Franchise Award does not raise a realistic prospect of an SLC for the Sheffield–London or Doncaster–London flows.

#### *Nottingham/Newark/Grantham–London*

146. The third party submitted that another group of passengers living in the area around Nottingham, Newark and Grantham currently choose between Nottingham, Newark and Grantham for travel to/from London (where journey times are similar) and that the Franchise Award may lead to competition concerns harming these passengers.
147. For Nottingham, Newark and Grantham to London, the Newark-London flow sees ICEC overlap with EMT but the service frequencies and journey durations are significantly different, with the one daily direct EMT service taking twice as long as the 33 daily direct ICEC services (144 minutes compared with 73 minutes). As set out above, the CMA therefore considers that the Newark-London flow does not give rise to a realistic prospect of an SLC.
148. The Parties submitted that between Nottingham and Grantham on the one hand, and Nottingham and Newark on the other, there are no settlements large enough to influence the Parties' decision making relating to prices.
149. The Parties further submitted that over [90–100]% of EMT passengers travelling between Nottingham and London live within [ ] miles of the Nottingham train station, indicating that they are probably not choosing between the EMT service at Nottingham and the ICEC service at Newark (22 miles from Nottingham) or Grantham (25 miles from Nottingham). Further, on the Grantham-London flow a third party rival, Hull Trains, operates seven services per day.
150. The CMA considers that the passenger figures above point to only a very small proportion of passengers on the Nottingham to London flow potentially considering the Newark to London flow as a credible alternative. Further, the

Parties are not able to charge different prices for passengers based on a customer's starting location.

151. Given the above, the CMA considers that the Franchise Award does not raise a realistic prospect of an SLC for the Sheffield–London or Doncaster–London flows.

#### *Bathgate/Falkirk–London*

152. Finally the third party noted that competition issues may arise for another group of passengers residing in the Bathgate/Falkirk area (a population of around 60,000 according to the third party) between Glasgow and Edinburgh. The CMA notes that the revenue share between the Parties was submitted to be around [80–90]% (ICEC) and [0–10]% (VWC).
153. For the Bathgate/Falkirk area the Parties submitted data that show fewer than [0–10,000] passenger journeys were made last year between Bathgate/Falkirk and London on either ICEC or VWC (with connections), amounting to less than £[0–500,000] in revenue. This compares with total revenue between Edinburgh and London of around £[0–60] million (on ICEC) and between Glasgow and London of £[0–30] million (on VWC).
154. The CMA therefore considers that even if passengers in the Bathgate/Falkirk area between Edinburgh and Glasgow were potentially choosing between ICEC and VWC to some extent, they would be doing so in insufficient numbers to make any material difference to the Parties' fare setting decisions.
155. The CMA considers that the revenue figures above point to only a very small proportion of revenues on the Edinburgh/Glasgow to London flows being accounted for by passengers buying rail tickets from Bathgate/Falkirk. Passengers buying Bathgate/Falkirk–London tickets are, therefore, unlikely to be determinative of pricing on the Edinburgh/Glasgow to London flows. Further, the Parties are not able to charge different prices for passengers based on a customer's starting location.
156. Given the above, the CMA considers that the Franchise Award does not raise a realistic prospect of an SLC for the Bathgate/Falkirk to London flow.

#### ***Rail-on-bus overlaps***

157. Stagecoach operates local bus services around the UK, some of which overlap (with regards to the geographic scope set out above) with ICEC. The CMA has considered whether the Franchise Award could lead to an increase in prices or worsening of quality/service levels (including the frequencies of

services) on either Stagecoach's bus services<sup>65</sup> (since customers lost as a result could switch to the Franchise) or on ICEC (since lost customers could switch to Stagecoach's bus services) on specific flows.

158. The Franchise Award gives rise to 28 overlaps between the ICEC Franchise and Stagecoach's existing local bus services, using the methodology outlined in the geographic frame of reference.
159. On all flows except Doncaster–Retford the CMA considers that there is no realistic prospect of competition concerns arising for the following reasons:
  - (a) ICEC derives at or close to 100% of revenue from inter-available fares on the majority of these flows with Scotrail being the lead operator setting these fares. It is therefore not realistic that Stagecoach will have the ability to raise the majority of fares on these ICEC overlap flows in order to divert passengers to its overlapping bus services;
  - (b) Scotrail offers a substantially more frequent service than ICEC across all times of day. Scotrail is a closer competitor to ICEC than bus services, since competition between the same modes of transport is likely to be closer than between modes. Therefore any action to degrade quality or service levels (including frequencies) on ICEC would be more likely to benefit Scotrail than Stagecoach bus services since the former is a closer competitor to ICEC than the bus services. The CMA therefore considers that the existence of Scotrail will continue to constrain the Parties after the Franchise Award; and
  - (c) the existence of Scotrail also constrains the ability and incentive of Stagecoach to increase prices or worsen services on its overlapping bus services as, given Scotrail's higher frequencies, ICEC is unlikely to gain a high enough proportion of passengers switching to rail to make the strategy profitable.
160. In relation to Doncaster–Retford the CMA considers that there is evidence that ICEC currently competes to some extent with the Stagecoach bus services. Stagecoach currently operates two bus routes (routes 29 (operated pursuant to a Nottingham County Council tender) and 99) on this flow. It operates 16 weekday services in total. The ICEC train service operates 9/11 weekday services, depending on the direction of travel.

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<sup>65</sup> With respect to the non-price factors which could be varied on buses on a flow, the CMA considers that these include: a reduction in frequency (in the middle of a route this would mean missing out stops for the relevant flow); increase in journey time by adding stops into the route (this could be done in conjunction with reducing the frequency of the flow, such that the rest of the journey time on the route is not as affected); use smaller buses which could lead to overcrowding (which could also be done in conjunction with reduced frequency).

161. The CMA focused its assessment on bus route 99, as this route number constituted the majority of Stagecoach’s bus passenger and revenue on this flow, and route 29 is a tendered route which the Parties submit reduces Stagecoach’s commercial freedom.<sup>66</sup>
162. While the CMA accepts that the bus services have a longer journey time than ICEC, the main ticket type on ICEC is double the price of the Stagecoach off peak ticket and around 56% more expensive than the peak ticket. The CMA therefore considers that the Parties’ rail and bus services may be seen as substitutes by at least some passengers when both price and duration are taken into account.
163. However, the CMA considers that there are third party train services that will constrain the Parties on this flow. The table below sets out the departure times of the three train services on this route.

<i>ICEC</i>	<i>Hull Trains</i>	<i>Northern</i>
5.36	7.21	10.04
6.36	9.25	11.04
10.25	11.26	12.03
12.25	13.25	13.04
14.25	16.05	14.04
16.25	18.03	15.04
17.46	20.03	16.03
18.26	-	
21.17	-	

164. The CMA notes that Northern journey time is approximately 120 minutes versus 13 minutes for Hull Trains and ICEC. The CMA therefore does not consider Northern to be a substitute to ICEC. The CMA notes that there are three ICEC services at times of day when no other TOC is operating (5:36, 6:36 and 21:17). However, the Parties submit that no Stagecoach bus operates at these times negating the prospect of the Parties engaging in a strategy to divert passengers. The ICEC services between 10am and 4:30pm would appear to be constrained by Hull Trains. ICEC would be likely to lose passengers to these services in the event of a price rise or worsening of services.

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<sup>66</sup> In respect to Stagecoach route 29, the Parties submit that the terms of the tender arrangement [REDACTED]. Although Stagecoach's fares on this route are [REDACTED], Stagecoach [REDACTED]. [REDACTED]. According to the Parties if [REDACTED]. In addition [REDACTED]. [REDACTED].

165. The Parties submit that [50–60]% of the passengers on the 99 bus service are concessionary bus passengers who travel for free on the bus but would not be able to do so on the train. Stagecoach would therefore be unable to divert such passengers to the train through price increases on bus.
166. The Parties also submitted an analysis performed on their behalf by an economics firm which modelled a 10% fare increase on Stagecoach’s bus services on this flow, estimating the number of passengers switching to ICEC taking into account bus to rail elasticity and ICEC’s proportion of rail industry revenue.<sup>67</sup> The CMA considers that there are several assumptions in the model which will impact materially upon the results obtained from it.<sup>68</sup> Nevertheless, the CMA notes that the result was a positive increase in profit with the vast majority of this gain coming from the higher yield on the bus services rather than being recouped from passengers switching to ICEC. The CMA therefore considers that the Franchise Award would not significantly alter Stagecoach’s existing incentives to set prices on its bus services.
167. Given the constraint from other rail services and the limited change in incentives on Stagecoach with respect to price setting on its bus services resulting from the Franchise Award, the CMA considers there to be no realistic prospect of an SLC as a result of the Franchise Award on any overlapping bus-rail flow.

### ***Rail-on-coach overlaps***

#### *Background*

168. Stagecoach operates Megabus, a low-cost, long distance inter-city coach service. Megabus has a network covering around 130 locations in the UK and also offers a sleeper service. Stagecoach also supplies combined coach/rail services under its Megabusplus branding. Megabusplus offers integrated journeys between Yorkshire, Lincolnshire and London on combined Megabus and EMT services.
169. Stagecoach also operates a joint venture with ComfortDelGro in Scotland: Citylink. Citylink operates coach services in Scotland and long-distance coach services between Scotland and England under both the Citylink and Megabus brands. Stagecoach has a 35% shareholding and financial interest in Citylink with the majority 65% share held by ComfortDelGro, a global transport provider. Stagecoach has, through a management agreement, [REDACTED].

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<sup>67</sup> The analysis used elasticity estimates from the Passenger Demand Forecasting Handbook v5.1.

<sup>68</sup> These assumptions include the elasticity not being flow specific, the diversion to cars and the yield used.

### *Unilateral horizontal effects*

170. The Parties submit that any theory of harm based on Stagecoach increasing prices on the Citylink services in order to divert passengers onto the ICEC service is not realistic given that Comfort DelGro could challenge and ultimately block any such strategy. The Parties provided examples of minutes from joint board meetings ([REDACTED]) scrutinising the day to day operations of Citylink including discussing fare prices. The Parties also note that the Shareholders' Agreement for Citylink provides that Stagecoach and ComfortDelGro must [REDACTED].
171. The CMA accepts that the ability of Stagecoach to raise prices on the Citylink services is therefore dampened by the presence and possible action of the majority shareholder. However the CMA notes that the 35% shareholding held by Stagecoach and its [REDACTED] will allow it to materially influence the policy of Citylink<sup>69</sup> including potentially blocking any potential lowering of prices, increases in frequency or enhancements in service quality that may otherwise maintain or increase the competitiveness of Citylink against ICEC.
172. On the basis of the considerations above, in relation to Citylink services, the CMA has therefore primarily considered whether there is a realistic prospect that Stagecoach could weaken Citylink as an effective competitor against ICEC via Citylink's commercial policy and strategy, potentially resulting in prices not being lowered or service levels not being maintained or enhanced on the coach services. In this way Stagecoach may be able to attract additional customers onto the ICEC Franchise.<sup>70</sup> The ownership structure means that Stagecoach may have an increased incentive to divert passengers to ICEC from Citylink given that it will receive 90% of any increase in profits on ICEC and risk only 35% of the losses on Citylink. The CMA considers that, on the other hand, the Parties' incentive to divert passengers from ICEC to Citylink will be muted as Stagecoach would only stand to gain 35% of any increase in profits from such a strategy.
173. In regards to the Megabus services solely operated by Stagecoach the CMA has considered whether the Franchise Award could result in an increase in price or a reduction in quality/service levels on the coach services due to the Parties' being able to capture diverted customers on the ICEC Franchise. The lack of regulation on coach prices gives operators an ability to alter prices in order to divert passengers onto their competing rail services. Concerns may

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<sup>69</sup> *Mergers: Guidance on the CMA's jurisdiction and procedure*, January 2014, paragraph 4.19.

<sup>70</sup> This is similar to the theory of harm in the CC's investigation Ryanair Holdings plc/Air Lingus Group plc.

also arise through Stagecoach reducing frequencies, removing coach services altogether or stopping the introduction of new services.

174. The CMA has also considered whether the Parties may have the ability and incentive to increase rail fares or reduce quality/service levels on rail services, in particular the ICEC, in order to divert passengers on Stagecoach Megabus services. While this ability is to some extent more restricted in regards to fares on rail services (due to regulation and restrictions in the Franchise agreement), the Parties may have the ability and incentive to increase unregulated rail fares or reduce quality/service levels on rail services, in particular the ICEC, in order to divert passengers onto Megabus.

#### *Framework for assessment*

175. The CMA has identified 39 overlaps between Stagecoach's coach services and the Franchise, using the methodology as set out in the geographic frame of reference.
176. As is the case when assessing rail-on-rail overlaps, the CMA does not consider there to be a realistic prospect of a lessening of competition on flows where one of the Parties' overlapping services has minimal annual revenue (ie below £500 revenue).<sup>71</sup> This was the case for four flows.<sup>72</sup>
177. In conducting its assessment the CMA has considered the extent to which the overlapping rail and coach services are comparable, taking into account their relative prices<sup>73</sup> and journey durations together.<sup>74</sup> In particular, where the longer journey times typical of coach services are offset by a lower price than that offered on rail this may mean that they may be considered as substitutes by a significant number of passengers.
178. The underlying rationale for this approach is that whether and to what extent rail services compete on particular flows and routes with coach services is an empirical question dependent on the degree of passenger demand

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<sup>71</sup> The CMA notes that flows with revenue increments below £500 also had very low numbers of passengers (less than 100).

<sup>72</sup> London BR–Bradford; London BR–Doncaster; London BR–Hull; Gleneagles–Perth.

<sup>73</sup> In its assessment the CMA has compared the main ticket type of ICEC with the average coach price on each flow, as provided in the Pro Forma. Where a range of prices were provided for the main ticket type for the relevant rail fare, the CMA has compared the lowest price in the range. The Parties submit that it is not appropriate to consider the lowest price. However, given that the ranges provided by the Parties are wide and the CMA has not been provided with numbers of tickets sold at each price point it is not possible to use an average price.

<sup>74</sup> This is consistent with a generalised cost methodology which includes in-vehicle time; the time spent travelling between the stops/stations at each end of the journey, and any additional cost in doing so (eg on fares); any 'interchange penalty' reflecting the need to change services or modes to complete a journey; the fare paid for the journey; and sometimes other aspects of the journey such as convenience, reliability or 'image' of the mode of transport used.

substitutability between the two modes on those particular flows and routes. The extent of substitutability depends on the particular characteristics of the flow in question. However, the OFT previously considered it reasonable to assume that, in the absence of empirical data or other evidence suggesting otherwise, a significant number of passengers might choose between coach and rail for a journey. It noted that passengers would weigh up factors such as travel time, convenience and cash cost and that those that primarily chose coach services tended to be more price sensitive and willing to accept longer journey duration in exchange for a lower price.<sup>75</sup> In the current case, third parties submitted that on some flows coach and rail compete for passengers.

179. Having assessed the extent to which the overlapping rail and coach services are comparable, the CMA considered whether an effective rail competitor exists, comparing the frequency of a competing rail service to the frequency of the ICEC service (as in the assessment used in the application of the 'effective competitor filter').<sup>76</sup> The CMA notes that the presence of an effective rail competitor as defined in the filter does not fully address the CMA's theory of harm with respect to coaches. This is because the constraint from a different mode of transport is more limited, and ICEC may receive a high enough proportion of passengers switching from coach in the event of a price rise or reduction in quality/service, to make the strategy profitable.
180. The CMA has, therefore, performed checks on the assumptions surrounding the existence of an effective rail competitor. These are as follows: on overlap flows where the effective competitor benchmark indicates that there is an effective rail competitor the CMA considers the percentage of annual rail industry revenue accounted for by ICEC both as a check that the rail competitor has in fact a substantial presence on the flow, and as a proxy for the proportion of diverted passengers from Stagecoach coach services that ICEC could reasonably be expected to capture. On a cautious basis, the CMA has considered in more detail flows for which ICEC has over 10% of annual rail industry revenue on the flow. The CMA has also assessed whether the times of day of the Parties' overlapping rail and coach services are likely to make these services the closest substitutes for passengers, and if so, these flows were considered in more detail.
181. Finally, in its assessment the CMA has considered whether there is an effective coach competitor present on the flow such as to mitigate any possible loss of competition as a result of the Franchise Award.

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<sup>75</sup> Anticipated acquisition by [National Express Group plc of the Greater Western franchise](#) (2005), paragraph 16.

<sup>76</sup> This refers to the existence of a third party rail service operating on each of these flows with a frequency of at least 50% that of ICEC.

### *Flows where an effective rail competitor is present*

182. The CMA considers that there is no realistic prospect of an SLC on nine flows.<sup>77</sup> This is due to the existence of a third party rail service operating on each of these flows with a frequency<sup>78</sup> of at least 50% that of ICEC; third party rail services being at similar times of day to ICEC services; and ICEC having a low percentage of annual rail revenue on the flow. The CMA therefore considers that any increase in price or degradation in quality/service on ICEC is more likely to benefit the third party rail service than Stagecoach coach services since an alternative rail service will impose more of a constraint on ICEC than a coach service. The CMA also considers that, based on the percentage of annual revenue attributable to ICEC on these flow, in the event of a price rise or degradation in quality/service on coaches, ICEC is unlikely to capture enough diverted coach passengers to make this a profitable strategy. For these reasons the CMA finds that no competition concerns arise on these flows.

### *Megabus/ICEC overlaps*

183. As regards to London–Falkirk and London–Stirling the CMA finds that there is limited exiting competition between the Stagecoach coach services and ICEC, as borne out by the low revenue increment as a result of the Franchise Award.

184. The CMA has assessed the following flows where there is an overlap between Stagecoach’s Megabus service and ICEC and, based on the methodology set out above, an indication of potential pre-merger competition between these services without a sufficiently effective rail competitor being present:

(a) London–Edinburgh.

(b) London–Glasgow.

(c) London–Perth.

(d) London–Bradford.

(e) London–Leeds.

(f) London–Newcastle.

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<sup>77</sup> Dundee–Aberdeen; Edinburgh–Glasgow; Edinburgh–Perth; Edinburgh–Stirling; Kingussie–Inverness; Leeds–Newcastle; Pitlochry–Aviemore; Pitlochry–Inverness; Stirling–Perth.

<sup>78</sup> By reference to the weekday frequencies of service offered by the single competitor with the most services.

(g) London–Wakefield.

(h) London–York.

185. In each of these flows the CMA considers that the Franchise Award will not give rise to a realistic prospect of an SLC given that a third party coach competitor, National Express, is present and would be expected to capture a significant degree of the passengers lost in the event of a price rise or worsening of services on Megabus. National Express has similar or larger service numbers on these flows. Further, the CMA received submissions from National Express that it was relatively easy to alter timetables and frequencies and that, should it be commercially attractive, it was simple to run additional coach services. Given that coach customers are more likely to consider a comparable coach service as an alternative compared to a train service the CMA considers the incentive and ability for Stagecoach to attempt to divert passengers onto ICEC is limited.
186. The CMA notes that the OFT, on long distance flows (such as the London to Scotland flows), has previously taken the view that low cost air carriers (but not more ‘traditional’ air travel) may constrain coach operators in attracting price sensitive passengers.<sup>79</sup> The Parties submit that a number of low cost air carriers are active on this flow and that the departure time of low cost air carriers on this flow are similar to that of the Megabus services. The CMA notes, however, that there are large price differentials between Megabus and airline services, suggesting that any constraint is limited. However, the CMA in the present case does not find it necessary to conclude on the constraint imposed by low cost air services in finding that there is no SLC on these flows.

#### *Scotland Citylink/ICEC overlap flows*

187. The CMA has assessed 12 overlap flows where the Citylink service overlaps with ICEC.<sup>80</sup> In none of these flows is a third party coach competitor present. In accordance with the framework for assessment set out above, the CMA considered whether the Citylink and ICEC services were comparable and therefore realistic alternatives for passengers wishing to travel on the particular flow. The CMA then considered whether an effective rail competitor exists which may constrain the Parties, noting that the theory of harm as regards the Citylink services is that Stagecoach may prevent actions to

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<sup>79</sup> [National Express/ICEC](#) (2007), paragraph 48.

<sup>80</sup> Dundee–Edinburgh, Perth–Pitlochry, Pitlochry–Kinguise, Stirling–Gleneagles, Edinburgh–Aberdeen, Edinburgh–Aviemore, Edinburgh–Inverness, Edinburgh–Kinguise, Edinburgh–Pitlochry, Perth–Avidemore, Perth–Inverness and Perth–Kinguise.

increase the competitiveness of Citylink as against ICEC. The existence of an effective competitor may reduce the incentive of Stagecoach to take such action as it may not be able to capture enough diverted passengers who may instead divert to competing TOCs rather than to ICEC.

188. The CMA notes that Citylink and ICEC have similar journey times and fare prices on these flows in some cases with ICEC offering cheaper fares than the coach fares. This suggests to the CMA that the services may be considered as alternatives and there may be a degree of price competition between the services. In assessing these flows, the CMA took into account both the frequencies of the competing services and the proportion of rail industry revenue accounted for by ICEC as these would inform Stagecoach's ability and incentives to divert passengers from coach to rail. That is, all else being equal, it is likely that the higher ICEC's frequencies and proportion of rail industry revenue, the greater its ability and incentive to divert passengers from coach to rail.
189. The CMA has considered the Dundee–Edinburgh and Edinburgh–Aberdeen flows further below as it found that different considerations apply.
190. With respect to the other flows, the CMA notes that ICEC operates only one service a day, compared with between four and eleven Citylink coach services, suggesting little pre-merger competition between Citylink services and ICEC. In addition, on each of these flows a rail competitor, Scotrail, offers between five and 16 services. Finally, ICEC accounts for less than [30–40]% of industry revenue. For these reasons, excluding Edinburgh to Aberdeen and Dundee–Edinburgh which are discussed in detail below the CMA considers there to be no realistic prospect of an SLC on the remaining Citylink flows.
191. As regards to Edinburgh–Aberdeen and Dundee–Edinburgh, the CMA considers that the following factors result in significant competition concerns:
  - (a) In contrast to the overlap flows discussed above there are a higher number of ICEC services on these flows making it more comparable to the number of Citylink services on this flow (four ICEC compared to seven Citylink on Edinburgh–Aberdeen and 14 on Dundee–Edinburgh) suggesting that the ICEC services are an alternative to passengers travelling on Citylink on various times of day and that there is greater competition existing between Citylink and ICEC.
  - (b) Although there are several Scotrail services which compete with the Parties as well as a smaller number of Cross Country services, ICEC accounts for a significant proportion of industry revenue (in particular on Edinburgh–Aberdeen with [40–50]% and [10–20]% on

Dundee–Edinburgh) suggesting that it may be profitable for Stagecoach to commence a diversion strategy.

(c) Modelling performed on behalf of the Parties suggests that where ICEC revenue is around [X]% of the rail industry revenue on the flow, there would be an overall positive impact from price increases on the Citylink services.<sup>81</sup> While the CMA notes that the ComfortDelgro majority shareholding means that Stagecoach unilaterally being able to make price rises for its own gain is not realistic this modelling may be used as a proxy for the level of possible diversion to ICEC if the Citylink services were made less attractive.

192. For these reasons the CMA considers that the Franchise Award gives rise to significant competition concerns on the Edinburgh–Aberdeen and Dundee–Edinburgh flows.

### **Multi-modal competition**

193. Conglomerate effects may arise in mergers of firms that are active in the supply of goods or services that do not form part of the same markets but which are nevertheless related in some way, either because their products are complements (so that a fall in the price of one good increases the customer's demand for another) or because there are economies of scale in purchasing them (so that customers buy them together).<sup>82</sup>

194. Most non-horizontal mergers are considered to be benign or even efficiency-enhancing (when they involve complementary products) and do not raise competition concerns. However, in certain circumstances, a conglomerate merger can result in the merged entity foreclosing rivals, including through a tying or bundling strategy.

195. Stagecoach's coach and/or bus services may be complementary to the rail services it will provide on the ICEC Franchise, for example where passengers use coach services to get to a train station before continuing their journey by train. In the current case, the CMA has considered the possibility that the Franchise Award could result in adverse effects on competition between coach and/or bus operators by enabling Stagecoach to leverage its position as a rail operator on ICEC to weaken (or foreclose) any competition on its coach and bus services. This may be possible through Stagecoach offering combined coach/bus and rail tickets restricted to its own services. This would

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<sup>81</sup> As noted above, the CMA interprets the model with caution given that there are several assumptions in the model which will impact materially upon the results obtained from it.

<sup>82</sup> *Merger assessment guidelines*, paragraph 5.6.2.

be a strategy whereby individual rail and coach/bus tickets would remain available but a combined, inter-modal ticket would be cheaper than the sum of the individual tickets.

196. When the OFT and the CC has considered this theory of harm previously,<sup>83</sup> it has been noted that multi-modal ticketing can be prima-facie pro-competitive but that concerns may arise in certain circumstances. Specifically, the OFT has noted that in extreme cases the adverse effects from excluding other transport operators from multi-modal ticketing could induce the exit of these other operators.
197. However, the CMA received a complaint from a third party in respect of coach services, in particular the Megabusplus service noting that Stagecoach currently offers integrated journeys between Yorkshire, Lincolnshire and London on combined Megabus coach and train services (the latter provided by East Midlands Trains).
198. The third party told the CMA that Stagecoach's operation of ICEC would leave rival coach operators at a disadvantage as Stagecoach could offer its Megabusplus product on the ICEC route, leveraging services it was obliged to offer under the Franchise agreement but that ordinarily would not reach capacity. Other coach operators would be left at a disadvantage through their lack of access to such rail services. The CMA therefore considers whether there would be a realistic prospect of an SLC arising from Stagecoach's ability to exclude other coach operators from offering these services on the ICEC routes.
199. The Parties submit that the Franchise Award is unlikely to give rise to any network market concerns. They submit that as recognised by the OFT in its Stagecoach/ICEC decision: 'ICEC is a high speed, long distance service with relatively few stops, it is serving a different need to that met by Stagecoach's local bus services...'.<sup>84</sup> The Parties do not consider that the features of the ICEC Franchise and local bus (or coach services) have a sufficient local nexus to give rise to network market concerns.
200. The Parties submit that there are a number of restrictions on the commercial viability of operating the Megabusplus service including:

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<sup>83</sup> Cases where this theory of harm was considered include: CC Report on the acquisition by [National Express Group plc of the Greater Anglia franchise](#) (November 2004); OFT Case ME/1347/04 – [FirstGroup plc/InterCity East Coast franchise](#) (21 December 2004), at paragraphs 67 to 69; OFT Case ME/1370/04 – [Virgin Group Investments Limited/Stagecoach Group plc/InterCity East Coast franchise](#) (21 December 2004), paragraphs 71 and 72; and OFT Case ME/2726/06 – [Stagecoach/South Western](#) (27 February 2007), paragraphs 56 to 61.

<sup>84</sup> Stagecoach/ICEC decision, paragraph 72; see also [FirstGroup/ICEC decision](#), paragraph 69.

- (a) Rail station/coach station access. There are very few stations on the GB rail network that readily provide for a possible rail/coach interchange.
- (b) Rail frequency restrictions. Megabusplus services can only be operated in conjunction with off-peak trains (due to capacity constraints) which limits the services on which a Megabus coach could connect with an ICEC rail service.
- (c) Megabus views the Megabusplus service [REDACTED] and has recently [REDACTED]:
  - (i) [REDACTED]
  - (ii) [REDACTED]
  - (iii) [REDACTED]

201. The Parties submit that a Megabusplus offering [REDACTED]. The Parties provided the CMA with internal documents which show that [REDACTED].

202. The CMA also notes that, according to the Parties' data, [REDACTED].

203. For these reasons and in the absence of any evidence regarding the potential impact on third parties should the Parties initiate Megabusplus services on the ICEC route the CMA considers that there is no realistic prospect of an SLC from conglomerate effects, specifically from the bundling of ICEC and Megabus tickets, as a result of the Franchise agreement.

## Countervailing factors

204. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.<sup>85</sup>

205. In this case, the CMA has not received sufficient evidence from either the Parties or third parties to conclude that entry or expansion meets these criteria. The CMA therefore considers that entry or expansion would not be sufficiently timely and likely to prevent a realistic prospect of an SLC as a result of the Franchise Award on the overlaps flows identified above.

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<sup>85</sup> *Merger assessment guidelines*, from paragraph 5.8.1.

## Third party views

206. The CMA contacted customers and competitors of the Parties as well as other interested third parties including industry bodies. A minority of third parties raised concerns regarding:
- (a) a competitor raised a concern regarding the ability of Stagecoach to provide Megabusplus services on ICEC routes;
  - (b) a competitor raised a concern that the Franchise Award may cause competition concerns in regards to passengers residing in an area between the ICEC and VWC, such that the two rail services could be considered substitutes; and
  - (c) a customer raised a concern that the Franchise Award will create a strong position for the Parties on rail routes between London and Scotland.
207. Third party comments have been taken into account where appropriate in the competitive assessment above.

## Conclusion on substantial lessening of competition

208. Based on the evidence set out above, the CMA believes that it is or may be the case that the Franchise Award may be expected to result in an SLC as a result of horizontal unilateral effects in relation to:
- (a) rail-on-rail overlaps on the Peterborough–Grantham flow;
  - (b) rail-on-rail overlaps on the Lincoln–Peterborough flow;
  - (c) coach-on-rail overlaps on the Dundee–Edinburgh flow; and
  - (d) coach-on-rail overlaps on the Edinburgh–Aberdeen flow.

## Exceptions to the duty to refer

209. Where the CMA's duty to refer is engaged, the CMA may, pursuant to section 33(2)(a) of the Act, decide not to refer the merger under investigation for a phase 2 investigation on the basis that the market(s) concerned are not of sufficient importance to justify the making of a reference (the **de minimis exception**). The CMA has considered below whether it is appropriate to use its discretion to apply the de minimis exception to the present case.

## ***Markets of insufficient importance***

210. In considering whether to apply the de minimis exception, the CMA will consider, in broad terms, whether the costs involved in a reference would be disproportionate to the size of the market(s) concerned, taking into account also the likelihood that harm will arise, the magnitude of competition potentially lost and the duration of such effects.<sup>86</sup> The CMA will not generally apply the de minimis exception where the size of the markets concerned exceeds £10 million.<sup>87</sup>
211. Data provided by the Parties indicates that the combined size of the market for the rail-on-rail overlaps on the Peterborough–Grantham and Lincoln–Peterborough flows is below £[0–5] million. The size of the market for the coach-on-rail overlaps on the Edinburgh–Dundee and Edinburgh–Aberdeen flows may be above £[10–20] million. However, in a previous decision<sup>88</sup> the OFT, in assessing whether the de minimis exception was applicable, had discounted revenue from transport services other than coach services in circumstances where the theory of harm focused on harm experienced by coach passengers. If the CMA were to adopt that approach in this case, and there may be valid arguments either way, the revenue under consideration would likely be less than £[0–5] million. However, it was not necessary for the CMA to take a view on the size of the affected markets in this case, because, as set out below, the CMA considers that it should not apply the de minimis exception in any event given that UILs are available ‘in principle’ in this case.

### *‘In principle’ availability of undertakings in lieu*

212. The CMA’s general policy, regardless of the size of the affected market, is not to apply the de minimis exception where clear-cut UILs could, in principle, be offered by the parties to resolve the concerns identified.<sup>89</sup>
213. In order for a UIL to be available in principle it must be:
- (a) sufficiently clear-cut; and
  - (b) not wholly disproportionate in relation to the concerns identified.

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<sup>86</sup> *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance* (OFT1122), December 2010, chapter 2. The *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance* was adopted by the CMA (see *Mergers: Guidance on the CMA’s jurisdiction and procedure*, Annex D).

<sup>87</sup> *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance*, paragraph 2.2.

<sup>88</sup> This was the OFT’s approach in its decision [National Express/Intercity East Coast rail franchise](#) (20 December 2007), from paragraph 81.

<sup>89</sup> *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance*, paragraphs 2.2 and 2.18-27.

214. For a UIL to be considered to be sufficiently clear-cut it must be clear that the competition concerns in the case are obviously such as to make the case a candidate for resolution by UIL.<sup>90</sup> In the present case the CMA considers that the Parties will be in a position to offer UILs that are proportionate and sufficiently clear-cut to address each of the flows in relation to which the CMA found a realistic prospect of an SLC.
215. With regard to rail-on-rail overlaps, the OFT has previously found a structural remedy (in combination with a behavioural remedy) was likely to address concerns it had identified at phase 1.<sup>91</sup> The CMA also notes that structural remedies have previously been found to address concerns arising specifically on flows operated by Stagecoach and Citylink, with those remedies consisting of the sale of certain coach services on the Glasgow–Aberdeen and Edinburgh–Inverness routes to a competing operator.<sup>92</sup>
216. Even if not all SLCs identified by the CMA in this case were to lend themselves to structural UILs, this would not necessarily prevent the CMA from concluding that UILs are available in principle. Although a clear-cut UIL will generally involve a structural divestment, behavioural UILs may represent a clear-cut remedy to the competition concern identified depending on the specific circumstances of the case.<sup>93</sup> The CMA notes in this respect that awards of rail franchises can be distinguished in certain ways from other mergers (for example, in the presence of regulation and restrictions on the operation of rail services provided for in the franchise agreement, as set out above). This was, for instance, found to be the case by the OFT in the Virgin and Stagecoach/ICEC decision where the OFT found a proposed behavioural remedy was ‘clear-cut’.<sup>94</sup> In the present case, the CMA also notes the specific nature of the Citylink joint venture that gives rise to the coach-on-rail overlaps in question.
217. Therefore the CMA considers that in the circumstances of this case it is open the Parties, in principle, to offer clear-cut undertakings to address the competition concerns identified. As such, consistent with the CMA’s policy not to apply the de minimis exception in circumstances where UILs are available in principle, the CMA finds that it would not be appropriate to consider this exception any further in the present decision.

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<sup>90</sup> Ibid.

<sup>91</sup> [Virgin Group Investments Limited and Stagecoach Group Plc/Intercity East Coast Mainline Franchise](#) (2004), paragraph 83.

<sup>92</sup> CC, Stagecoach and Scottish Citylink (2006).

<sup>93</sup> *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance*, paragraph 5.43.

<sup>94</sup> [Virgin and Stagecoach/Intercity East Coast rail franchise](#) (21 December 2004), paragraph 88. The OFT also accepted a behavioural remedy in the Arriva/Wales and Borders rail franchise (16 March 2004). The CC accepted behavioural remedies in the FirstGroup/ScotRail franchise case (report of 25 June 2004).

## **Decision**

218. Consequently, the CMA believes that it is or may be the case that the Franchise Award may be expected to result in an SLC within a market or markets in the United Kingdom.
219. The CMA therefore considers that it is under a duty to refer under section 33(1) of the Act. However, the duty to refer is not exercised pursuant to section 33(3)(b) whilst the CMA is considering whether to accept undertakings under section 73 of the Act in lieu of a reference. Pursuant to section 73A(1) of the Act, the Parties have until Friday 13 February 2015 to offer an undertaking to the CMA that might be accepted by the CMA under section 73(2) of the Act. If the Parties do not offer an undertaking by this date, if the Parties indicate before this date that they do not wish to offer an undertaking, or if pursuant to section 73A(2) of the Act the CMA decides by Friday 20 February 2015 that there are no reasonable grounds for believing that it might accept the undertaking offered by the Parties, or a modified version of it, then the CMA will refer the Merger for a phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act.

**Andrea Coscelli**  
**Executive Director, Markets and Mergers**  
**Competition and Markets Authority**  
**6 February 2015**