

Anticipated acquisition by DSB (through Lyne Limited in which it is intended that English Welsh & Scottish Railway Holdings Limited will be a minority shareholder) of the Intercity East Coast Passenger Rail Franchise

The OFT's decision on reference under section 33 given on 8 December

Please note square brackets indicate figures excised at the request of the parties or information excised at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **DSB UK Limited (DSB)** is part of **DSB Group** which operates the Danish State railway system and is an independent public corporation which is wholly-owned by the Danish Ministry of Transport. The Group operates urban, intercity, regional and international passenger rail services within Denmark and other European countries including Sweden. The DSB Group achieved turnover of DKK8.9 billion (approximately £835 million) for year ended 31 December 2003.
2. **English Welsh and Scottish Railway Holdings Limited (EWS)** is a UK-incorporated company. Its activities are divided into four business units: rail freight haulage; rail industry services; rail passenger charter services; and non-freight operations. These services are provided through the following main operating companies: (i) English Welsh & Scottish Railway Limited, (ii) Rail Express Systems Limited and (iii) English Welsh & Scottish Railway International Limited. For the year ended 31 March 2004, EWS achieved a turnover of £516.4 million.
3. **InterCity East Coast Passenger Rail Franchise (ICEC)** currently encompasses intercity passenger rail services between London, parts of East Anglia, the East Midlands, Yorkshire, Humberside, the North East of England and Scotland. The ICEC franchise was awarded to Great North Eastern Railway Limited (GNER) in 1996 for a period of seven years and was subsequently extended for a further period of two years to expire on 1 May 2005. For the 52 weeks ended 4 January 2004, the current incumbent GNER had a UK turnover of £429,083,000.

TRANSACTION

4. DSB has set up a special purpose vehicle, LYNE Limited (LYNE), through which it intends to acquire ICEC. Subject to approval by the Strategic Rail Authority (SRA) it is intended that EWS will acquire 29.1 per cent of shares in LYNE and DSB will acquire 70.9 per cent of shares. DSB/EWS was one of four bidders to pre-qualify, following the consultation stage of the franchising process, for the ICEC franchise. The deadline for delivery of the bids to the SRA is 6 December and the SRA is scheduled to award the ICEC franchise to the successful bidder in February 2005.

JURISDICTION

5. As a result of the transaction, DSB/EWS and the ICEC Franchise will cease to be distinct. The award of a rail franchise constitutes an acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993 (as amended). ICEC's turnover in the UK in the last financial year was in excess of £70 million, therefore, the transaction meets the turnover test in section 23 of the Enterprise Act 2002 (the Act). The OFT believes that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation for the purposes of section 33(1)(a) of the Act.

RELEVANT MARKET

Product Scope

Rail Passenger Services

6. ICEC is a rail passenger franchise and any Train Operating Company ('TOC') operating the franchise will supply public passenger rail transport services.
7. DSB does not operate any mode of passenger transport service in the UK. As stated in paragraph 2 above, EWS provides rail passenger charter services to charter companies. This involves offering special passenger trains for use by charter companies for events such as corporate hospitality and providing locomotives and train crew to the Venice Simplon-Orient Express service as well as to the UK Royal Train Services. The nature of demand for chartered services is entirely distinct from the scheduled passenger services offered by TOCs. EWS does not offer services directly to passengers or engage in marketing or ticketing activities, and the provision of rolling stock for charter services requires a different operating licence than for a passenger TOC. Consequently, DSB and EWS do not overlap with the ICEC in the provision of rail passenger transport services. Accordingly, no further consideration is given to rail passenger transport services in this decision.

Light Maintenance Depot Services

8. The parties overlap in the supply of light maintenance depot services. Post transaction, the ICEC-owned light maintenance depots will transfer to LYNE.
9. ICEC generates approximately 3 per cent of its franchise revenue from the provision of passenger rail light maintenance depot services to third parties.¹ Contracts for the provision of light maintenance depot services are generally awarded through a bidding process.
10. The OFT has, in previous cases, drawn a distinction between 'light maintenance' and 'heavy maintenance' whilst recognising a convergence between the two types.² Light maintenance involves day-to-day maintenance such as repairs, interior and exterior cleaning, component exchanges and re-fuelling. These services are generally carried out overnight. Heavy maintenance services (not normally carried out more than once a year) and refurbishment services involve trains being taken out of service in depots that tend to be located in more remote locations. DSB/EWS contend that neither the ICEC Franchise depots nor the EWS depots located in the ICEC Franchise territory offer dedicated heavy maintenance or refurbishment services to any material extent.³
11. A distinction can also be drawn between freight and passenger light maintenance depots although it is possible that freight light maintenance depots and passenger light maintenance depots are interchangeable with respect to certain limited services such as re-fuelling and minor repair services.
12. On the demand side, TOCs cannot use a freight maintenance depot for light maintenance to passenger trains, other than for limited refuelling and minor repair services detailed above. These limited services alone mean that companies operating only freight maintenance depots are unlikely to be successful in bidding for a passenger train maintenance contract.
13. On the supply side, the cost and time required to convert a freight depot to provide light maintenance depot services to passenger trains varies significantly from one depot to another. Third parties indicate that, depending on the specific requirements of the depot, investment of £30,000 to £8 million would be required

¹ DSB's estimate of revenue generated from light maintenance services based on limited financial data made available to it as part of the bidding process for the ICEC Franchise.

² Proposed acquisition by DaimlerChrysler Rail Systems (UK) Limited (Adtranz) of Railcare Limited – 20 November 2000.

³ The ICEC Craigentny depot is capable of some limited heavy maintenance services and the ICEC Bounds Green depot has carried out some refurbishment work. However, both depots are said to serve predominantly light maintenance services.

to install washing facilities, extra re-fuelling facilities, and additional platforms to allow access to the train's interior and also the installation of pits to allow access beneath the train.

14. Overall, it has not been necessary in this case to reach a final view on the appropriate frames of reference since no competition issues arise howsoever they are defined. For the purposes of the analysis below, the OFT has considered the competitive effects of the transaction on the supply of light maintenance depot services to passenger trains and light maintenance depot services to freight trains.

Geographic scope

15. A passenger light maintenance depot that is located approximately 50 miles (with a journey time under one hour) from where trains are stabled is a viable option for TOCs. This is because mobilising rolling stock for the purpose of light maintenance involves additional costs and increases downtime of trains. Accordingly, the relevant geographic frame of reference is viewed as being a distance of approximately 50 miles or a journey time of no more than one hour between the location of overnight train stabling and the location of a depot.

HORIZONTAL ISSUES

16. Post transaction there will be eight light maintenance depots under the ownership of either EWS or ICEC. The following four depots provide passenger rail light maintenance services:
 - Craigentenny (Edinburgh) - ICEC
 - Clayhills (Aberdeen) - ICEC
 - Bounds Green (London) - ICEC
 - Tyne Yard (Newcastle) - EWS
17. The remaining depots currently provide light maintenance services for freight trains only. These are:
 - Millerhill (Edinburgh) - EWS
 - Motherwell - EWS
 - Thornaby (Middlesbrough) - EWS
 - Doncaster - EWS
18. In the supply of light maintenance depot services to passenger trains, there are currently no overlapping depots within a distance of 50 miles from where the trains are stabled or within a journey time of one hour.

19. The question arises however whether EWS could convert a freight maintenance depot located within a 50 mile radius or one hour journey time from an ICEC depot to provide light maintenance depot services for passenger trains. This might raise competition concerns if there are no alternative depots within a 50 mile radius or one hour journey time able to supply or rapidly start supplying light maintenance depot services for passenger trains in competition with EWS post merger. In this circumstance, the EWS freight depots in Edinburgh (Millerhill) and Motherwell would be sufficiently close to ICEC's Edinburgh (Craigentinny) passenger depot for this concern potentially to arise. .
20. At present neither the Millerhill nor Motherwell depots provide light maintenance depot services for passenger trains. The ICEC Craigentinny depot provides passenger rail light maintenance services for GNER (current ICEC franchisee) and Bombardier (Virgin Cross Country passenger trains). The EWS and the ICEC depots currently have different operational specifications. EWS' Millerhill depot is a small freight maintenance depot and has had only a minimal amount of third party revenue in recent years (arising from a small number of occasional fuelling stops by other freight operators). The Motherwell depot is also a small freight depot.
21. Virgin Cross Country Trains is the main third party customer for light maintenance services in Edinburgh because it has no light maintenance depots of its own in the area or in other parts of the ICEC territory. EWS previously offered the Millerhill and Motherwell depots in a request for tenders in May 2000 to provide light maintenance depot services to Virgin Cross Country passenger trains. []. The contracts were awarded to the ICEC's depot in Craigentinny (Edinburgh) and West Coast Traincare's Polmadie (Glasgow) depot.
22. EWS estimates that investment of approximately [] would be required to its Millerhill depot before it could offer [] diesel passenger trains with fuelling, safety checks, minor repairs, water tank replenishment, interior and exterior washing and excavation of train toilet services. The Motherwell depot is estimated to require approximately [] in investment to provide the same services to [] per night.
23. []. Third party responses have also indicated that such investments are unlikely to be undertaken in the absence of a specific contract over which to amortise the costs. Since its last bid in 2000, the Millerhill depot has not made any further bids for passenger rail light maintenance depot services contracts. EWS has closed the depot building at Millerhill in 2004 and only makes use of the other facilities at the site.
24. In these circumstances, although the EWS depots have previously bid for Virgin Cross Country passenger maintenance depot services contracts, it is not realistic

to consider EWS's freight depot as a significant competitor for such contracts. In any event, there are a number of other passenger rail light maintenance depots in the area of potential overlap that can and do offer passenger light maintenance services. ScotRail operates light maintenance depots at Edinburgh-Haymarket and Corkerhill (near Glasgow) and also plans a new depot at Eastfield (Glasgow). Also situated near Glasgow is West Coast Traincare's Polmadie depot, which is one of the current suppliers of light maintenance depot services to Virgin Cross-Country.

Barriers to entry and expansion

25. Evidence as to the obstacles to construction of a new light maintenance depot for passenger trains is mixed. Third parties have suggested that barriers to entry into the supply of light maintenance depot services are high. This is primarily due to the limited availability of suitable land adjacent to the main rail line. Further, if a land site is not already connected to Network Rail, it will require a connection agreement with Network Rail which is costly (approximately £500,000) and time consuming to obtain. Moreover, costs of depot construction and re-signalling of tracks are estimated to be in the range of £5-30 million, amounting to a sizeable level of capital expenditure. Third party responses have also indicated that they are unlikely to consider building new depots in the absence of a contract with a TOC to amortise costs. Other impediments such as difficulty in obtaining planning permission were put forward by third parties.
26. However, some recent developments suggest that the barriers to entry are not insurmountable as evidenced by a number of planned new passenger rail light maintenance depots, for example, ScotRail's Eastfield (Glasgow) depot and TPE's facilities in York and Manchester.

Buyer power

27. TOCs will usually request tenders for light maintenance depot services in a particular location. The nature of a tender process does give TOCs some degree of buyer power. Most TOCs however require light maintenance services in specific areas on a regular basis such that only a certain number of depots are available at any point in time.

VERTICAL ISSUES

28. This transaction does not raise any vertical competition issues.

THIRD PARTY VIEWS

29. A number of third parties including passenger committees and competing light maintenance depot operators were contacted. Generally, no concerns were raised.

ASSESSMENT

30. The EWS depots at Edinburgh and Motherwell do not provide light maintenance services to passenger trains but provide such services to freight trains. As such, the EWS freight depots do not currently compete with the ICEC depots. This is significant in relation to ICEC's depot located at Edinburgh. EWS has two freight depots at Edinburgh and Motherwell which are within a viable distance to be regarded as potential substitutes.
31. It is plausible that EWS could convert its freight depots in Edinburgh and Motherwell to provide light maintenance services to passenger trains at some future point. However, this would involve a significant amount of investment by EWS which is considered to be prohibitive, particularly where no existing contract exists to amortise such costs. In any event, even if EWS were to convert its depot, there are currently a number of alternative light maintenance depots in the Glasgow area able to provide a competitive constraint on EWS and ICEC.
32. In conclusion, therefore, the OFT does not believe that it is or may be the case that the merger may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

33. This merger will therefore **not be referred** to the Competition Commission under section 33(1) of the Act.