

# Anticipated acquisition by First TransPennine Express Limited of the TransPennine Express franchise

## Decision on relevant merger situation and substantial lessening of competition

**ME/6586/16**

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 14 March 2016. Full text of the decision published on 4 April 2016.

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 9 December 2015, the Department for Transport (**DfT**) announced that the TransPennine Express rail franchise (**TPE** or the **TPE Franchise**) had been awarded to First TransPennine Express Limited (**FTPE**) (the **Franchise Award**), an indirect wholly-owned subsidiary of FirstGroup plc (**FirstGroup**). The TPE Franchise is currently operated by First/Keolis TransPennine Limited (**First KTPE**), a joint venture between FirstGroup and Keolis SA, in which FirstGroup is the majority shareholder. In this decision, FirstGroup, FTPE and TPE are together referred to as the **Parties**.
2. The Competition and Markets Authority (**CMA**) has assessed the TPE Franchise under the merger control provisions of the Enterprise Act 2002 (the **Act**). The TPE Franchise qualifies for investigation under those provisions since FTPE is considered as acquiring control of the TPE Franchise by virtue of section 66(3) of the Railways Act 1993, and the turnover test is met. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
3. Consistent with the CMA's previous decisional practice relating to the assessment of rail franchise awards, in assessing the Franchise Award the

CMA has been mindful of competition for the market (ie competition for rail franchises). In terms of 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. The CMA therefore considers that there is no realistic prospect of a substantial lessening of competition (**SLC**) for rail franchises as a result of the Franchise Award.

4. As regards competition in the market, the Parties overlap in the supply of public transport services in the UK, ie bus (FirstGroup) and rail (FirstGroup and TPE). The CMA has assessed the extent of competition between the Parties' services and third party service 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 therefore assessed the impact of the Franchise Award with respect to bus-on-rail and rail-on-rail overlaps between the Parties' services and considered whether there is a realistic prospect that the Franchise Award will give rise to an SLC.
6. As regards rail-on-rail overlaps, overall, the CMA considers that the Franchise Award does not give rise to a realistic prospect of an SLC, given the competitive constraint exercised by Northern Rail, which is the principal competitor on the overlapping flows between Selby and Hull, and the very small share of dedicated fares on the Parties' rail operations on these flows.
7. In relation to bus-on-rail overlaps, the CMA could not rule out that the Franchise Award may give rise to a realistic prospect of horizontal effects resulting in an SLC on the Huddersfield–Marsden flows, noting in particular the Parties' very high shares in the provision of both bus and rail services.
8. The CMA has also considered the possibility that the Franchise Award could result in adverse effects on competition between bus operators by enabling FirstGroup to leverage its position as a rail operator on TPE to weaken (or foreclose) any competition on its bus services. This may be possible through FirstGroup increasing the individual fare prices unless a combined ticket was purchased and offering combined bus and rail tickets restricted to its own services. In summary, the CMA believes that there was insufficient evidence to suggest that there is a realistic prospect of an SLC as a result of conglomerate effects arising from the Franchise Award.

9. In conclusion, the CMA cannot rule out that the Franchise Award may result in an SLC as a result of horizontal unilateral effects in relation to the bus-on-rail overlap on the Huddersfield-Marsden flows. However, the CMA has decided that, should there be a realistic prospect of an SLC as a result of the Franchise Award on these flows, it would in any event exercise its discretion to apply the market of insufficient importance (*de minimis*) exception to the duty to refer.
10. The Franchise Award will therefore **not be referred** under section 33(1) of the Enterprise Act 2002 (the **Act**).

## ASSESSMENT

### Parties

11. FTPE is an indirect wholly-owned subsidiary of FirstGroup established on 2 July 2014 for the purpose of bidding for and operating the TPE Franchise. As a newly formed company, FTPE has not yet traded and therefore did not generate any turnover in 2014/2015.
12. FirstGroup is a public limited company listed on the London Stock Exchange, which operates public transport services in Europe (primarily the UK) and North America. FirstGroup currently has two rail franchises: the Great Western Franchise (operated by First Great Western Limited, now trading as Great Western Railway) and the current TPE Franchise (operated by First KTPE). FirstGroup is also owner of Hull Trains Limited (**Hull Trains**), an open access passenger train operator which runs services between Hull and London King's Cross. In addition, it operates a concession for the Tramlink service between Croydon and Wimbledon on behalf of Transport for London. FirstGroup also provides local bus services around the UK, including in the area covered by the TPE Franchise – Manchester, South Yorkshire, West Yorkshire, East Scotland and Glasgow. The turnover of FirstGroup in 2014/2015 was around £6.1 billion worldwide and around £3.1 billion in the UK.
13. The TPE Franchise provides inter-urban rail services across the north of England, offering direct connections between the major cities of Liverpool, Manchester, Leeds, Sheffield and Newcastle and other cities and towns in the north. The TPE Franchise also provides cross-border services between north west England and Scotland. The DfT is the franchising authority for the TPE Franchise. Certain services of the current TPE Franchise are due to be remapped into the new Northern rail franchise immediately prior to

commencement of FTPE's operations,<sup>1</sup> and the CMA has therefore not taken these services into account in its assessment of the Franchise Award. Further, as from January 2018, TPE will take over some of the services currently provided under the Northern franchise, which the CMA included in its assessment.<sup>2</sup>

14. First KTPE, a joint venture between First Group and Keolis SA with FirstGroup as majority shareholder,<sup>3</sup> is the operator of the current TPE Franchise. The turnover of First KTPE in 2014/2015 was £269 million.

## Transaction

15. On 9 December 2015, the DfT announced that the TPE Franchise had been awarded to FTPE. Following the award, the DfT and FTPE entered into a franchise agreement and associated agreements on 22 December 2015. The TPE Franchise is due to commence on 1 April 2016 for a term of seven years, expiring on 1 April 2023 (subject to a possible extension of up to two years).

## Jurisdiction

16. The Franchise Award constitutes the acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. FTPE and the TPE Franchise will therefore cease to be distinct.
17. The UK turnover of the TPE Franchise exceeds £70 million<sup>4</sup> and therefore the turnover test in section 23(1)(b) of the Act is satisfied. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

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<sup>1</sup> See TPE Franchise Agreement, Schedule 6.2. As part of these DfT mandated arrangements, FTPE will not provide the following services operated by the current TPE Franchise: (a) Blackpool North to/from Manchester Airport; (b) Barrow-in-Furness to/from Manchester Airport; (c) Windermere and Oxenholme and Windermere to/from Manchester Airport. In addition, as from commencement of the new TPE Franchise, FTPE will not be the operator of certain stations (Arnside, Barrow-in-Furness, Birchwood, Burneside, Carnforth, Kendal, Grange-over-Sands, Staveley, Ulverston, Warrington Central and Windermere) and driver depots (Barrow-in-Furness and Blackpool) operated by the current TPE Franchise. The franchise agreement also includes requirements mandated by the DfT for FTPE and the new Northern franchise to undertake some rolling stock and train crew hire arrangements between each other during the opening periods of the new franchises to support continuity of services in the immediate aftermath of remapping.

<sup>2</sup> From 2018 onwards, the TPE Franchise will additionally call at Marsden, Slaithwaite and Greenfield railway stations, introducing 18 additional overlaps between Huddersfield and Manchester and these three stations. Northern Rail will continue to offer services on this flow after this date but to a more limited degree.

<sup>3</sup> FirstGroup (55%) and Keolis SA (45%).

<sup>4</sup> As noted above, First KTPE is the current operator of the TPE Franchise and in 2014/2015 its turnover was £269 million. Although the TPE Franchise will cover a smaller number of services, this will not reduce the TPE Franchise revenue to below £70 million.

18. The initial period for consideration of the Franchise Award under section 34ZA(3) of the Act started on 19 January 2016 and the statutory 40 working day deadline for a decision is therefore 14 March 2016.

## Counterfactual

19. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). For anticipated mergers, the CMA generally adopts the prevailing conditions of competition as the counterfactual against which to assess the impact of the merger.<sup>5</sup>
20. However, in rail franchises, 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 as the award of the franchise to a train operating company (**TOC**) that raises no competition concerns or where any concerns could be remedied through undertakings in lieu (**UILs**) of a reference to phase 2.<sup>6</sup> Accordingly, in so far as the operation of the TPE Franchise is concerned, the CMA will assess the Franchise Award against a counterfactual whereby the TPE Franchise is awarded to a TOC raising no competition concerns or where any competition concerns could be remedied through UILs.<sup>7</sup>

## Frame of reference

21. 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>8</sup>
22. The Parties overlap in the supply of public transport services, including bus (FirstGroup) and rail (FirstGroup and TPE).

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<sup>5</sup> *Merger Assessment Guidelines* (OFT1254/CC2), September 2010, from paragraph 4.3.5. The *Merger Assessment Guidelines* have been adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, Annex D).

<sup>6</sup> *Merger Assessment Guidelines*, paragraphs 4.3.28-29.

<sup>7</sup> See, for example, *ME/6506/14 Intercity Railways Limited/ICEC Franchise*, CMA (2014), paragraph 22.

<sup>8</sup> *Merger Assessment Guidelines*, paragraph 5.2.2.

## **Product scope**

### *Competition for the market*

23. As regards competition for the market, the CMA considers that the relevant product frame of reference is the award of franchises. However, the CMA does not need to conclude on this matter since no competition concerns arise on any plausible definition of this market.

### *Competition in the market*

24. 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>9</sup> The CMA does not have sufficient evidence to suggest that private transport, including transportation by car, is a significant constraint on any of the overlap flows considered.<sup>10</sup>
25. There are various modes of public transport (eg rail and bus) that are available to passengers wishing to make a particular journey.<sup>11</sup> The CMA considers as a 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 local, inter-urban, long distance, etc) as well as the price of the journey.<sup>12</sup> The CMA has therefore considered these constraints from both within and between modes of transport (bus and rail) on a flow-by-flow analysis in the competitive assessment.
26. The Competition Commission (CC), one of the CMA's predecessors, has previously distinguished leisure travel from business travel and commuting due to different sensitivities of the various customer groups to price, journey

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<sup>9</sup> See, for example, CC, *Review of methodologies in transport inquiries* (2007); [ME/6470/14 Govia Thameslink Railway Limited/Thameslink, Southern and Great Northern Rail Franchise](#), CMA (2014), paragraph 24; [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 32.

<sup>10</sup> In response to the CMA's assessment of the Franchise Award, a third party referred to the Office of Rail and Road's *Impact Assessment of the CMA's Options for Increasing On-Rail Competition* (31 December 2015) in which it is stated that the degree of competition between rail and other modes of transport (particularly car, but also coach and aviation) will vary greatly across different routes and flows (paragraph 2.2.2; see, also, paragraph 9.3.3 for a discussion on the impact that lower fares will have on an overall increase in rail demand and a reduction in car use). However, this does not form a sufficient basis for the CMA to take private transport into account in its competitive assessment of specific flows.

<sup>11</sup> [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 33.

<sup>12</sup> [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 33.

time and duration.<sup>13</sup> In the present case, 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.

### ***Geographic scope***

#### *Competition for the market*

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

#### *Competition in the market*

28. 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,<sup>14</sup> the CMA assesses the impact of the Franchise Award on a flow-by-flow basis, where a 'flow' is defined as a connection between two specific points.
29. The CMA uses the following definitions of overlaps in this case.

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

30. The Parties identified rail-on-rail overlaps where their rail services served the same point-to-point journeys.
31. The CMA considers that rail-on-rail overlaps could occur in the following ways:
- (a) Journeys between the same two stations.
  - (b) Journeys between the same two settlements, even where different stations in the same settlement are used.
  - (c) Journeys to a main commuter city (such as Manchester) from two alternative stations in nearby towns or villages.

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<sup>13</sup> CC, *Review of methodologies in transport inquiries* (2007). See, also, [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 34.

<sup>14</sup> See above under footnote 9.

32. The CMA has considered all such rail-on-rail overlaps in its competitive assessment, although no additional overlaps were identified under (b) and (c) above.

#### *Bus-on-rail overlaps*

33. The Parties applied the following criteria to identify bus-on-rail overlaps:<sup>i</sup>
- (a) 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.<sup>15</sup>
  - (b) For flows involving travel to or from an urban area (either at one or both ends), bus stops and train stations were treated as overlapping where there was a distance of no more than 1,200 metres between them.<sup>16</sup>
  - (c) 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.
34. The CMA has applied this methodology in its analysis of bus-on-rail overlaps but did not identify any additional overlaps under (c) above. The CMA has considered all bus-on-rail overlaps in its competitive assessment below.

## **Competitive assessment**

### ***Horizontal unilateral effects***

#### *Competition for the market*

35. Consistent with the CMA's previous decisional practice relating to the assessment of rail franchise awards,<sup>17</sup> the CMA has been mindful of the impact of the Franchise Award on competition for the market (ie 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.

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<sup>15</sup> See [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 41.

<sup>16</sup> As above.

<sup>17</sup> See, for example, [ME/6473/14 National Express Group/Essex Thameside Franchise](#), CMA (2014), paragraph 25; [ME/6470/14 Govia Thameslink Railway Limited/Thameslink, Southern and Great Northern Rail Franchise](#), CMA (2014), paragraph 35; [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 46.

36. The Parties estimate that the Franchise Award increases FirstGroup's share of UK rail franchise revenues to [10-20%] with an increment of [0-5%].<sup>18</sup>
37. The CMA considers that competition for the market could be affected by the Franchise Award if it could lead to a reduction in the number of bidders available for future bids, or provide the Parties with an incumbency advantage relative to other bidders in future bids for franchises. The CMA considers that given the relatively small market share and increment 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. No third parties raised concerns about the impact of the Franchise Award on competition for the market.
38. The CMA therefore considers that there is no realistic prospect of an SLC in the market for rail franchises as a result of the Franchise Award.

*Competition in the market: rail-on-rail overlaps*

39. As noted above, FirstGroup currently has two rail franchises: the Great Western Franchise and the current TPE Franchise. FirstGroup also operates Hull Trains, which is the open access passenger train operator that runs services between Hull and London King's Cross.
40. The CMA has considered whether the Franchise Award could lead to an increase in fares and/or a reduction in service quality (including for example an impact on journey time and frequency of service) on either the TPE Franchise or Hull Trains which would result in customers switching from one service to the other.<sup>19</sup> In each case the CMA has considered the extent to which the Parties may have the incentive and ability to increase fares or degrade services, taking into account, where relevant, the factors listed in the framework for assessment that was applied in the bus-on-rail overlaps in paragraph 63 below.
41. The Parties submitted that there are a very small number of overlaps between the TPE Franchise and Hull Trains, which arise on the following flows between Selby and Hull:

(a) Hull–Brough;

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<sup>18</sup> Total UK franchises by revenue. This is calculated on the basis that Great Western Franchise is the only other franchise operated by FirstGroup as at 1 April 2016.

<sup>19</sup> TPE Franchise services do not overlap with the services of the Great Western Franchise.

- (b) Hull–Howden;
  - (c) Hull–Selby;
  - (d) Brough–Howden;
  - (e) Brough–Selby; and
  - (f) Howden–Selby.
42. The CMA considers that there is no realistic prospect of competition concerns arising on any of these flows for the reasons set out below.
43. Northern Rail is the principal competitor to both TPE and Hull Trains on the overlap flows, offering similar journey times to TPE and Hull Trains (ie about 36 minutes). Virgin Trains East Coast also operates a number of services on three of these flows.<sup>20</sup> In addition to rail competitors, TPE also faces competition from bus operators on several of these flows.<sup>21</sup>
44. The overwhelming majority of the revenue generated for TPE and Hull Trains (about [X%]) on these flows was from the sale of inter-available tickets (where the prices are set by Northern Rail as lead operator).<sup>22</sup> The Parties submit that Northern Rail is expected to remain the lead operator on these flows.<sup>23</sup> The total value of sales of dedicated tickets for the TPE Franchise and Hull Trains on all the overlap flows amounted to only [£5,000-10,000] in the last financial year. As the share of revenue derived from the sale of dedicated tickets is small, this means that neither TPE nor Hull Trains has the ability (in so far as inter-available fares are concerned) or incentive (in so far as dedicated fares are concerned) to increase fares in order to encourage customers to switch from one service to the other.
45. The Parties' combined share of rail revenue on each of these flows is close to [40-50%]. Their combined revenue for the last financial year across all the overlap flows for the TPE Franchise and Hull Trains was less than [X] (where total rail revenues on the overlap flows amounted to [X]). This represents less than [0-5%] of FirstGroup's total rail activities.

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<sup>20</sup> Hull–Brough, Selby–Hull and Selby–Brough.

<sup>21</sup> However, journey times for travel by bus are considerably longer (close to two hours) and therefore services may not be substitutable.

<sup>22</sup> Inter-available fares are set by the lead operator (ie the operator with the greatest commercial interest on a certain route) and must be observed by all train operators selling tickets for that journey or operating a service on some or all of the route. Other operators can set dedicated (ie unregulated) fares for travel only on their own trains.

<sup>23</sup> Northern Rail is the largest operator on two-thirds of the overlap flows (ie Hull–Brough, Hull–Howden, Selby–Howden and Howden–Brough) and meets the criteria for qualifying as lead operator.

46. No third parties raised concerns regarding the rail-on-rail overlaps resulting from the Franchise Agreement.
47. In view of the above, the CMA considers there to be no realistic prospect of an SLC arising as a result of the Franchise Award on the overlapping rail-on-rail flows.

*Competition in the market: bus-on-rail overlaps*

48. FirstGroup currently operates local bus services around the UK, some of which overlap with TPE (in line with the geographic scope set out in paragraphs 33 and 34 above).
49. The theory of harm the CMA has considered is whether the Franchise Award could lead to an increase in fares and/or a reduction in service quality (including impact on journey time and frequency of service) on either FirstGroup's local bus services (since customers lost as a result could switch to the TPE Franchise) and/or on the TPE service (as lost customers could switch to FirstGroup's local bus services). As noted above (paragraph 25), in general, the CMA considers 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. Nonetheless, in each case the CMA has considered the extent to which the Parties may have the incentive and ability to increase fares or degrade services in order to encourage switching from one mode to the other, taking into account the closeness of competition between the parties' services, the constraint provided by other operators, the margins earned on each service, the effects on other connected flows and regulatory constraints as set out in more detail below.
50. The CMA has focused its assessment on whether there is a realistic prospect that the Parties could weaken local bus services, through increased prices or a reduction in service quality. This is because local bus services are not subject to the same degree of regulation as rail services and therefore there is a greater degree of flexibility for the operator. However, the CMA has also considered the reverse position (that is, the ability and incentive to raise prices or degrade quality on TPE due to the ability to recoup profits on the overlapping bus services) given that the TOCs retain some flexibility in relation to fares and quality (for example making certain changes to frequencies, fares or the ticket mix in order to maximise revenues by attracting passengers from its existing overlap services).

## Filters

51. The Parties identified 101 flows<sup>24</sup> where FirstGroup's existing bus services overlap with TPE's rail service using the methodology set out in paragraph 33 above.<sup>25</sup> The Parties submit that it is appropriate to use a filtering approach on the point-to-point overlap flows to focus on those flows most likely to generate possible concerns.
52. Following the approach taken in the CC's Bus Market Investigation,<sup>26</sup> the Parties proposed filtering out 20 flows of limited distance where stations on those flows are less than 3.2 km (2 miles) apart. The CMA considered the results of this filter and found that rail competition was present on these flows.<sup>27</sup> The CMA therefore found it appropriate to rule out competition concerns arising on these flows.
53. The Parties also proposed filtering out a further 11 flows where a direct rail journey on the TPE Franchise was not possible. The CMA notes that Northern Rail is the lead operator on these flows.<sup>28</sup> The CMA found it appropriate to rule out competition concerns arising on most of these flows. However, as TPE's revenue was approximately [redacted] on one of these flows and accounted for approximately [35-45%] of rail revenue on the flow, the CMA considered it possible that the Parties may have the incentive to induce switching and therefore this flow was included in the CMA's detailed competitive assessment.<sup>29ii</sup> Therefore, 10 flows were filtered out on this basis.
54. On the remaining flows,<sup>30</sup> the Parties proposed applying the following three filters in order to exclude from the CMA's competitive assessment:
  - (a) TPE rail services where less than one TPE service is offered per day;<sup>31</sup>
  - (b) FirstGroup bus services where FirstGroup's share of bus travel (based on bus service frequency) is less than 50%;

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<sup>24</sup> Station to station pairs, where the overlapping bus route stops within 1,200 m of each station.

<sup>25</sup> As noted above, as from January 2018, TPE will take over some of the services currently provided under the Northern franchise. Certain services and stations within the current TPE Franchise will also be remapped into the new Northern franchise immediately prior to the commencement of the new TPE Franchise. These service reconfigurations have been taken into account in the filtering analysis described above, applying separate checks for the position forecasted both in 2016 and 2018.

<sup>26</sup> CC, *Local bus services market investigation*, 2011, Appendix 11.2.

<sup>27</sup> TPE's total revenue on these flows was less than [redacted] in the last financial year (representing [0-5%] of TPE's total revenue). The flow with the highest revenue filtered out on this basis was Manchester Piccadilly–Salford with less than [redacted] generated by TPE in the last financial year.

<sup>28</sup> TPE's revenue on 10 of these 11 flows was less than [redacted] on each of them.

<sup>29</sup> This is the Manchester–Warrington flow.

<sup>30</sup> 71 flows or 63 treating Manchester Victoria, Manchester Piccadilly and Manchester Oxford Road as one station.

<sup>31</sup> In practice, this did not remove any additional flows because, where TPE's rail services were infrequent, TPE's share of rail revenue was also low and the total revenue generated on the flow was minimal.

- (c) TPE rail services where TPE's share of rail travel (based on weekly rail frequency) is less than 50%.
55. The CMA considers it appropriate to adjust the three filters above to a more cautious approach so overlaps are excluded from the CMA's competitive assessment only where:
- (a) TPE's share of rail services based both on frequency and rail revenue is less than 30%;
- (b) FirstGroup has less than 50% of the total bus services on the flow (in each of the four timetable periods)<sup>32</sup> and competing bus operators offer a comparable service to FirstGroup in terms of journey time and therefore provide a competitive constraint.
56. Using this approach, 39 additional flows were removed from detailed assessment.
57. The CMA has performed a sensitivity check to ensure that flows where any potential competition concerns could arise (for example, due to the amount of revenue generated) were not filtered out.<sup>33</sup>
58. The CMA has set out below the framework used when considering each of the remaining 24 bus-on-rail overlaps.<sup>34</sup>

### *Background*

59. The Parties submit that the regulatory environment that the TPE Franchise will operate within is no different to that of other franchises that the CMA has reviewed.<sup>35</sup> As such, TPE will be subject to significant regulation around fares and operational performance. 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. The Parties submit that the TPE Franchise agreement places significant constraints on FTPE's ability to alter the quality (for example, the frequency of services and number of carriages) or pricing of the services it offers. However, the operator may have freedom to alter other parameters of quality outside those regulated in the franchise agreement as well as considerable commercial freedom to set

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<sup>32</sup> Peak, off-peak, Saturdays and Sundays.

<sup>33</sup> Leeds–Huddersfield. FirstGroup's share of the market was less than [20-30%] (based on bus service frequency). However, TPE generated over [£<] on this flow in the last financial year holding nearly a [90-100%] share of rail travel (in terms of rail revenue), so the CMA has considered this flow more closely in its competitive assessment.

<sup>34</sup> ie 101 – (20 + 10 + 8 + 39) where Manchester Victoria, Manchester Piccadilly and Manchester Oxford Road are treated as one station (see footnote 30 above).

<sup>35</sup> See [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 52-60.

unregulated prices, and therefore the CMA considers that where regulated fares make up a low proportion of revenue on a flow, increased prices and reductions in quality may remain a concern.<sup>36</sup>

60. In relation to bus services, the Parties submit that there has been a significant increase in the oversight of bus services by local transport authorities. The Parties further submit that this oversight of local bus services significantly reduces any incentives on the part of FirstGroup to degrade its bus services (in terms of bus quality and minimum frequencies to be provided by bus operators), as it would expect to encounter opposition from local transport authorities, which is likely to be significant (particularly with respect to the award of future tenders and influence over key operational drivers such as traffic priority measures).
61. The Parties submit that, across much of the bus network where there are bus-on-rail overlaps in the present case, FirstGroup has adopted a pricing policy based only on distance travelled with a large proportion of revenue generated from day (or network) tickets. In order for bus fares to increase on a particular flow, FirstGroup would need to abandon this simple pricing structure and/or increase the price of the standard tickets offered across the network (which would have the unintended consequence of penalising bus passengers who did not wish to travel on the particular flow concerned and would therefore be unprofitable if those passengers decided to switch away from FirstGroup's bus service). This may impact FirstGroup's incentive to make flow specific changes to smaller flows which do not generate a significant amount of revenue.
62. The CMA has taken these regulatory factors into account where relevant in its competitive assessment.

#### *Framework for assessment*

63. The CMA has considered the following factors in its assessment of bus-on-rail overlaps:<sup>37</sup>
  - (a) Revenue share: The CMA took into account the share of revenue generated by each of the Parties on the relevant bus and rail flows. If the share of revenue on any of the bus or rail services is low, this indicates that the incentive to increase fares is also likely to be low given that a

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<sup>36</sup> 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>37</sup> Certain of these factors have previously been considered in, for example, the CC's *Review of methodologies in transport inquiries* (2007), paragraph 27. See, also, [ME/6506/14 Intercity Railways Limited/ICEC Franchise](#), CMA (2014), paragraph 67.

large proportion of customers would most likely switch to competing services.

- (b) Margins: The Parties provided information on the profit that would be earned on certain overlapping bus and rail flows. In most cases, the profits were relatively similar for each of the Parties' overlapping services, suggesting that there is no particular incentive for an operator to adjust fares in order to try to move passengers from one transport mode to another.<sup>38</sup> The CMA has considered in its analysis those flows where there are differences in margins which could result in certain (relatively low margin) passengers being harmed as a result of fare increases intended to encourage them to switch to a mode of transport with higher profit margins. The differences in fare levels between bus and rail are a good estimate for differences in margins, because the marginal cost of carrying an additional passenger is very small for both rail and bus services.<sup>39</sup>
- (c) 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 data is available:
- (i) frequency;
  - (ii) departure and arrival times of services (within for example peak and off-peak time bands). Particularly where there are a limited number of services, the arrival and departure times of the individual services may be a better indication of competition lost as a result of the Franchise Award than frequencies;
  - (iii) average journey time; and
  - (iv) price of the main (ie the most sold) ticket type on the flow.
- (d) Internal documents: The CMA considers that, where available, 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 and has taken into account the documents provided by the Parties

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<sup>38</sup> In a horizontal merger, prices may rise (or quality fall) on either or both of the overlapping products or services due to the loss of a competitive constraint. If one of the services (eg rail) was significantly more profitable than the other (eg bus) then there could be a strong incentive to raise the price of the (potentially less regulated) bus fares. This could cause passengers to switch services and increase the margin earned on each passenger which may make the potential incentive to raise prices higher.

<sup>39</sup> The main marginal cost is the commission that the rail operator pays on ticket sales in some circumstances.

(including bid documents, board and management papers) where relevant.

- (e) Other evidence: where relevant the CMA has also taken account of other direct and indirect evidence provided by the Parties and third parties, including survey evidence.<sup>40</sup>

#### *Flow-by-flow assessment of bus-on-rail overlaps*

64. As noted above, the Franchise Award gives rise to 101 overlaps between FirstGroup's existing local bus services and the TPE Franchise.
65. Applying the filtering approach described in the preceding sections, the CMA considers that there could be possible concerns in the 24 remaining flows (which in some cases are considered as sets of flows ie encompassing a group of flows on the same bus route(s) in the description of a single overlap). Therefore, the CMA has set out below its assessment as to whether the Franchise Award could result in an SLC on any of these 13 sets of flows.

#### *Carlisle–Edinburgh*

66. TPE overlaps with FirstGroup's X95 bus service. The Parties overlap only on the end-to-end journey, following markedly different intermediate routes between Carlisle and Edinburgh.
67. FirstGroup has a [90-100%] share of the bus service on this flow but it only generated [£] in revenue in the last financial year, which represents [0-5%] of FirstGroup's total revenue on the route as a whole.
68. TPE's revenue share of rail travel on this flow is [35-45%] (or [50-60%] by rail frequency). Revenue generated was [£] in the last financial year.
69. The bus journey takes over two hours longer than the train, suggesting that these two modes of transport may not be close substitutes on this flow (meaning that few passengers would be expected to switch services in response to a change in fare or quality).<sup>41</sup>

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<sup>40</sup> This includes the Illuma survey provided by the Parties. Illuma is a monthly survey carried out by FirstGroup's bus division to measure customer satisfaction with its bus services. The CMA placed limited weight on this evidence as sample sizes for specific flows were small. In addition, the Parties submitted evidence on the 'inefficiency' of walking to the nearest bus stop (where bus stops overlap) compared to taking the train (if the desired end point was the train station). For certain short distance flows, the extra walking distance required would make it unlikely that passengers would take the bus if not convenient for the train station and the CMA has taken this into account in the calculation of bus revenue on overlapping flows (ie it has been reduced when earned from inconvenient bus stops).

<sup>41</sup> The CMA checked journey times of all bus services (ie those offered by both FirstGroup and competing operators) against actual timetables published online.

70. TPE faces competition from Virgin Trains (InterCity West Coast) with similar journey times. This suggests that, even if passengers were willing to switch from bus to rail due to an increase in fares or a deterioration in service quality, the Parties would only be expected to recapture a proportion of those passengers with a certain proportion expected to switch to Virgin Trains.
71. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

#### *Leeds–Huddersfield*

72. TPE overlaps with FirstGroup's X6 bus service, although, the X6 bus follows a markedly different route to TPE.
73. FirstGroup's share of the bus service on this flow is only [15-25%] in terms of bus frequency. FirstGroup's revenue on this flow amounted to [£] in the last financial year, representing [15-25%] of total revenue on the whole of the X6 route.
74. TPE's share of rail travel is [65-75%] by reference to rail frequency or [£] on the basis of revenue share.<sup>42</sup> TPE's revenues on this flow in the last financial year were relatively high (just over [£] million).
75. Travel by train on this flow is significantly faster than travel by bus. The journey takes about 20 minutes on TPE, while FirstGroup's bus service is almost four times slower. This suggests that these two modes of transport may not be close substitutes on this flow.
76. Northern Rail will continue to operate on this flow throughout the term of the TPE Franchise. In addition, FirstGroup's bus service faces strong bus competition from Arriva, the other bus operator on this flow which has a significant share of bus services on this flow of approximately 70%.
77. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

#### *Leeds–Cottingham*

78. TPE will overlap with FirstGroup's 1, 2, 3A, 51, 52, 55, 74 and 87 bus services from 2018 onwards. As several services follow circuitous routes or are evenings/Sunday only, the Parties submit that only the 55 bus service is

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<sup>42</sup> TPE has a higher revenue share as it operates faster services than Northern Rail.

relevant. However, the CMA has considered all of the overlapping bus services on this flow in its assessment.

79. FirstGroup has a [50-60%] share of this flow in terms of bus frequency. Revenue generated by FirstGroup on this flow was relatively low and amounted to [£] in the last financial year, which represents about [5-10%] of total revenue on the relevant routes.
80. After 2018, TPE is expected to have a share of rail frequency (and revenue) of approximately [25-35%] (its revenue for that year is estimated at [£]).
81. The journey time on this flow is five minutes on TPE's service, while most of FirstGroup's buses take between 20-50 minutes, suggesting that these two modes of transport may not be close substitutes on this flow.
82. TPE will face competition from Northern Rail on this flow, while, in terms of bus competition, Arriva operates about 40% of the bus services on this flow.
83. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

#### *Leeds–Morley*

84. TPE will overlap with FirstGroup's 51, 52, 55, 74 and 87 buses from 2018 onwards. Morley is the next station after Cottingley from Leeds.
85. FirstGroup has around [50-60%] of the local bus services on this flow in terms of bus frequency and its bus revenue during the last financial year was [£], which represents [10-20%] of total revenue on the relevant routes.
86. After 2018, TPE is expected to have a share of rail frequency and revenue of [50-60%] with estimated revenue for that year amounting to [£].
87. The journey time on this flow by train is 10 minutes, while FirstGroup's fastest bus service is 15 minutes<sup>43</sup> (the 55 bus), although most of its buses take 30-50 minutes and do not stop very close to the train station.<sup>44</sup> For some passengers rail and bus could therefore be considered substitutes.
88. Single bus and rail fares are similar in price, while the return rail ticket is lower than the equivalent bus fare.<sup>45</sup> Therefore, degrading one service would not lead to an increased margin on any passengers who divert to the Parties'

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<sup>43</sup> As confirmed by the Parties.

<sup>44</sup> For example, the closest bus stop on the 55 bus is 700 metres from Morley train station.

<sup>45</sup> Rail single fare £2.40, bus £2.30. Return bus £4 (day ticket), and rail £3.30- £3.60 (off-peak/peak).

other mode which does not suggest an increased incentive for such action as a result of the Franchise Award (see paragraph 63(b) above).

89. TPE will face competition from Northern Rail on this flow which can be expected to act as a constraint. In relation to bus services, FirstGroup faces strong bus competition from Arriva which operates about 40% of bus services on this flow that are of comparable duration (23-38 minutes).
90. As the Parties face strong competitive constraints, the CMA considers that they may have limited incentives to increase fares and/or degrade services.
91. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

#### *Leeds–Garforth*

92. TPE overlaps with FirstGroup’s 19 and 19A bus services.
93. FirstGroup’s share of the local bus services on this flow is almost [45-55%] in terms of bus frequency. Bus revenue amounted to [£] in the last financial year, representing [5-10%] of total revenue on the relevant routes.
94. TPE’s revenue share of rail travel on this flow is only [30-40%] (or [20-30%] by rail frequency). Revenue generated on this flow was [£] in the last financial year.
95. The journey time is seven minutes on TPE’s service, but over half an hour by bus, which suggests that these two modes of transport may not be close substitutes on this flow.
96. TPE faces competition from Northern Rail with similar journey times (11 minutes). All bus competition is provided by Arriva whose buses run at between 29-38 minutes on this flow, which is a similar journey time to FirstGroup’s services and also generates around 50% of the revenue in terms of bus frequency.
97. The level of rail and bus fares are about equal, which suggests that degrading one service would not lead to an increased margin on any passengers who divert to FirstGroup’s other mode, even if these two modes of transport were considered to be suitable alternatives (see paragraph 63(b) above).<sup>46iii</sup>

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<sup>46</sup> Bus single £2.80, rail £2.70. For return bus is £4 (Leeds day ticket), while rail is £4.10-£4.60 (off-peak/peak) with a commission up to 10%. Commission is paid to stations that are not operated by TPE for retailing tickets.

98. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

*Dore & Totley–Meadowhall*

99. TPE overlaps with FirstGroup’s 703 bus service, which is a school service. FirstGroup started operating this bus on 2 November 2015 with only one bus service per (school) day to Meadowhall. The rail service is also infrequent, running about three services per day.
100. FirstGroup is only expecting annual revenue of about [£] on this flow which is primarily derived from school students. Rail revenue is also very low ([£] in the last financial year). The data shows that TPE has [90-100%] of the rail frequency but only [30-40%] of revenue which could be because most train passengers take indirect journeys via Sheffield on other operators’ services.
101. There is also a significant difference in journey time with the train taking 15 minutes and the bus over one hour, which suggests that these two modes of transport may not be close substitutes on this flow.
102. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

*Doncaster–Sheffield (via Meadowhall)*

103. TPE overlaps with FirstGroup’s X78 bus service. This service comprises the following sets of flows: Doncaster to Sheffield and the shorter Doncaster to Meadowhall.
104. FirstGroup has a [90-100%] share of this bus service in terms of bus frequency. However, its revenue in the last financial year was relatively low at [£] and represented only [0-5%] of FirstGroup’s total revenue on the route as a whole.
105. TPE’s revenue share of rail travel on this flow is about [30-40%] (or below [20-30%] in terms of rail frequency). In the last financial year, it generated [£] in revenue.
106. The journey by train takes 26 minutes, whereas by bus the journey is almost 90 minutes, which suggests that these two modes of transport may not be close substitutes on this flow.<sup>47</sup>

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<sup>47</sup> Although in the opinion of one third party, bus competes with rail in this case, given that FirstGroup provides a service every 10 minutes. Another third party raised concerns that FirstGroup will soon control the ‘Bus Rapid

107. Rail fares are about 20-30% higher than bus fares which suggests that the Parties may have some incentive to raise bus fares to induce switching to rail.<sup>48</sup> However, TPE generates a relatively low share of the rail revenue and so would not be expected to re-capture a large number of passengers switching to rail.
108. TPE also faces competition from a number of third party rail operators on this flow (Northern Rail, CrossCountry and East Midlands).
109. For these reasons, the CMA believes that there is no realistic prospect of an SLC arising in relation to this flow.

#### *Manchester–Warrington*

110. TPE overlaps with FirstGroup's 100 bus service between Manchester (Piccadilly) and Warrington Central. The Parties' services will overlap until December 2017 and subsequently the service will be run by Northern Rail.
111. FirstGroup's share of the bus service on this flow in terms of bus frequency is [90-100%]. In the last financial year, FirstGroup generated revenue of only [£] on this flow and this represents just [0-5%] of its revenue on the whole route.
112. TPE's share of rail revenue on this flow is [35-45%] (or [30-40%] by rail frequency). Revenue generated on this flow in the last financial year was [£].
113. TPE takes 20-25 minutes to complete this journey, while the bus journey takes between 90-120 minutes, which suggests that these two modes of transport may not be close substitutes on this flow.
114. In addition, since the flow represents a particularly small proportion of revenue on the route, given the bus pricing policy in place (see paragraph 61 above), the Parties' incentives to make changes to the fares as a result of reduced competition on this flow may be diluted by the impact of such increases (ie the loss of passengers) on more profitable flows on the route.
115. Further, there is rail competition from both East Midlands and Northern Rail which will continue to constrain the Parties.

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Transit' scheme as well as the X78 bus service. The 'Bus Rapid Transit' scheme consists of infrastructure improvements that are likely to decrease bus journey times post-July 2016 from Sheffield to Doncaster.

<sup>48</sup> Bus singles £3.50 while rail is £4.40 (Meadowhall) and £4.60 (Sheffield) before commission of up to 9%. Return is £5 by bus (day ticket South Yorkshire) while £6.20-£7.10 (off-peak/peak Meadowhall) and £6.50/£7.20 (off-peak/peak Sheffield).

116. For these reasons, the CMA believes that there is no realistic prospect of an SLC in relation to this flow.

*Bolton–Manchester (Deansgate)*

117. TPE overlaps with FirstGroup’s 8, 36 and 37 bus services. This overlap comprises the following set of flows: Bolton to Manchester and Bolton to Deansgate.
118. FirstGroup has a [90-100%] share of the bus services on this flow in terms of bus frequency and it generated [£] in revenue during the last financial year. However, this represents less than 10% of FirstGroup’s total revenue on the relevant routes.
119. TPE’s revenue share of rail travel is approximately [25-35%] on Bolton–Deansgate and [25-35%] on Bolton–Manchester. In total, TPE generated [£] in revenue in the last financial year on this set of flows.
120. Although fares on the bus and rail services are similar,<sup>49</sup> TPE’s service takes 20 minutes, while the bus journey takes approximately an hour,<sup>50</sup> which suggests that these two modes of transport may not be close substitutes on this flow.
121. TPE faces competition from Northern Rail, which offers similar journey times.
122. For these reasons, the CMA believes that there is no realistic prospect of an SLC in relation to this flow.

*Manchester–Huddersfield*

123. TPE overlaps with FirstGroup’s 184 bus service. The Parties overlap only on the end-to-end journey between Huddersfield and Manchester, following different routes entering Manchester. TPE services will commence stopping services at intermediate stations between Huddersfield and Manchester in 2018 when most of these services transfer from Northern Rail. This will include operations between Huddersfield and Mossley, which will create further overlaps between the Parties.<sup>51</sup>
124. The majority of public transport passengers on these overlap flows use the train. FirstGroup’s share of the bus service on this set of flows is [90-100%] in

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<sup>49</sup> Single bus ticket £4 while rail is £4-4.20 (off-peak/peak). Return on bus is £4.20 (day Manchester) and rail £4.10-6.40 (off-peak/peak).

<sup>50</sup> In the opinion of one third party, bus competes with rail on this flow.

<sup>51</sup> The additional flows that overlap only with the 184 bus service are Huddersfield–Greenfield, Marsden–Greenfield, Slaithwaite–Greenfield, Manchester–Marsden and Manchester–Slaithwaite.

terms of bus frequency.<sup>52</sup> Bus revenue was [£] on this flow in the last financial year but represents only [0-5%] of FirstGroup's revenue on the route as a whole. After 2018 (when the intermediate stations and flows are added to TPE's rail operations), the proportion of FirstGroup's bus services that overlap with TPE will increase and therefore FirstGroup's share of route revenue will increase to [5-10%] (with estimated annual revenue of [£]).

125. TPE will have a [85-95%] share in terms of rail frequency on all the major rail flows overlapping with the 184 bus service post 2018. TPE's revenue on the Huddersfield to Manchester flow is estimated at [£] post-2018, increasing by almost [£]. There is therefore a significant difference in the revenue generated by the two modes of transport on these flows which suggests that they do not compete closely.
126. TPE's rail journey takes 35 minutes on average (and 45 minutes post 2018), while the bus service is much slower, running at almost two hours. In addition, single fares are approximately three times higher on rail than on bus. Return fares are three to four times higher on rail (during peak hours).<sup>53</sup>
127. In relation to rail, Northern Rail will remain a competitive constraint on each of these flows post 2018.
128. For these reasons, the CMA believes that there is no realistic prospect of an SLC in relation to this set of flows.

#### *Manchester–Greenfield*

129. TPE will overlap with FirstGroup's 180, 184 and X84 bus services from 2018 onwards.
130. FirstGroup has a [90-100%] share of local bus services on this flow in terms of bus frequency, but its bus revenue in the last financial year was only [£]. This represents less than 10% of FirstGroup's revenue on the relevant routes taken as a whole.
131. TPE's share of rail revenue on this overlapping flow in 2018 is expected to be approximately [85-95%] with rail revenue of [£] for that year. There is therefore a significant difference in the revenue generated by the two modes of transport on this flow which suggests that they do not compete closely.

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<sup>52</sup> A third party commented that FirstGroup has a significant presence in local bus operations in this area.

<sup>53</sup> Bus single £4, rail is £12.60 (or maybe [£] with commission). Return bus is £4.20-£4.70 (first day Manchester or West Yorkshire depending on direction of travel), rail is £12.80 -£18.30 (off-peak/peak) or [£] with commission ([0-5%] commission as flow involves Huddersfield).

132. The journey time by train is 18 minutes, while the bus takes 44-60 minutes (or longer). FirstGroup's fast bus service (X84) which takes 44 minutes only runs twice per weekday during each of peak and off-peak hours, while TPE is expected to offer approximately 123 services per week. These significant differences in journey times and frequency suggest that the two modes of transport may not be close substitutes on this flow.
133. For these reasons, the CMA believes that there is no realistic prospect of an SLC in relation to this flow.

*Stalybridge–Greenfield (via Mossley)*

134. TPE will overlap with FirstGroup's 350, 353 and 354 bus services from 2018 onwards. This bus service is comprised of the following set of flows: Stalybridge to Mossley, Mossley to Greenfield and Stalybridge to Greenfield.
135. FirstGroup has a share of approximately [45-55%] of bus services on this set of flows but generated revenue of only [£] in the last financial year, which represents [10-20%] of FirstGroup's revenue on the route as a whole.
136. Rail revenue in the last financial year was also relatively low at [£]. After 2018, once TPE starts to operate these flows, its share by rail frequency will be about [45-55%] on Greenfield–Mossley and about [85-95%] on Greenfield–Stalybridge and Stalybridge–Mossley.
137. TPE's service will take less than 10 minutes and FirstGroup's local bus service 21 minutes.
138. FirstGroup faces bus competition from Stagecoach, Stotts and Manchester Community Transport, whose combined share of bus services on this set of flows is 40%.
139. The 353 and 354 are tendered services. The Parties submit that FirstGroup cannot unilaterally alter these services without the consent of the competent transport authority and any degradation in services would result in services being retendered. Fare levels submitted with the tender bid must be consistent with commercial fares generally charged in the same area. Therefore, the Parties submit that it would be difficult for FirstGroup to impose a fare rise on this flow under the circumstances.
140. For these reasons, the CMA believes that there is no realistic prospect of an SLC in relation to this set of flows.

*Huddersfield–Marsden (via Slaithwaite)*

141. TPE will overlap with FirstGroup’s 183, 184, 185 and 186 bus services (and with the 181 bus only between Slaithwaite and Huddersfield) from 2018 onwards. This bus service consists of the following set of flows: Huddersfield to Slaithwaite, Slaithwaite to Marsden and Huddersfield to Marsden.
142. FirstGroup’s share of bus services in terms of bus frequency is [75-85%] on the Slaithwaite–Huddersfield flow, [90-100%] on Slaithwaite–Marsden and [90-100%] on Huddersfield–Marsden. FirstGroup’s revenue in the last financial year for this set of flows was relatively large and amounted to approximately [£], which represents [20-30%] of its total revenue for the relevant routes taken as a whole.
143. After 2018, TPE is expected to have a [55-65%] share of rail travel on Marsden–Slaithwaite and [85-95%] on each of Huddersfield–Slaithwaite and Huddersfield–Marsden in terms of rail frequency. Revenues for the first year are estimated at [£].
144. The journey time by train is about nine minutes and although FirstGroup’s buses take almost 30 minutes, they offer more frequent services. This means shorter waiting times at the bus stop and could act as a trade-off to the slightly longer journey time, and therefore may represent a substitute for some passengers.<sup>54</sup>
145. In terms of fare structure, fares for single and return journeys on rail are lower (by between 20-40%) than on bus.<sup>55</sup>
146. In terms of bus competition, competitors are currently active on Slaithwaite to Marsden<sup>56</sup> and Huddersfield to Slaithwaite.<sup>57</sup> FirstGroup submits that there is also potential competition from Arriva/Yorkshire Tiger as it would be relatively easy for them to extend their operations on the flow. In relation to rail, [£]. This suggests that other rail operators will offer only limited competition on this overlap.
147. In view of the Parties’ high shares in the provision of both rail and bus services and the fact that the services may be close substitutes for some

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<sup>54</sup> TPE offers 120 services per week, whereas FirstGroup has 180 bus services scheduled per weekday.

<sup>55</sup> Single Huddersfield-Marsden is £2.50 rail or £2.90 bus, while Huddersfield-Slaithwaite is the same price on bus and £1.70 rail. Return is £3.90/£4.70 (Day West Yorkshire or Halifax/Huddersfield off-peak) while rail is £3.40-3.70 Marsden (off-peak/peak) and £2.50-2.60 (Slaithwaite). For Slaithwaite-Marsden bus single is £2.10 and rail is £1.60. Return is £3.90/£4.20 (two singles or Halifax/Huddersfield off-peak), rail is £2.30-2.40 (off-peak/peak). Commission is [0-5%] due to Huddersfield.

<sup>56</sup> J.R.T

<sup>57</sup> TLC Travel and E Stott & Sons Ltd

passengers, the CMA cannot rule out that the Franchise Award may give rise to significant competition concerns on the Huddersfield–Marsden overlap.

#### *Conclusion on horizontal unilateral effects*

148. As set out above, the CMA could not rule out that the Franchise Award may give rise to an SLC as a result of horizontal unilateral effects in relation to the Huddersfield–Marsden overlap. For the reasons set out above, the CMA believes that the Franchise Award does not give rise to an SLC in relation to any of the other bus-on-rail overlap flows.

#### ***Conglomerate effects***

149. 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>58</sup>
150. FirstGroup's bus services may be complementary to the rail services it will provide on the TPE Franchise, for example where passengers use bus 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 bus operators by enabling FirstGroup to leverage its position as a rail operator on TPE to weaken (or foreclose) any competition on its bus services. This may be possible through FirstGroup increasing the individual fare prices unless a combined ticket was purchased and offering combined bus and rail tickets restricted to its own services.
151. When the Office of Fair Trading (OFT) and the CC considered this theory of harm previously,<sup>59</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.
152. Conglomerate effects could also arise if FirstGroup could bundle bus and rail tickets to encourage its TPE rail passengers to also use its local buses

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<sup>58</sup> [Merger Assessment Guidelines](#), paragraph 5.6.2.

<sup>59</sup> Most recently, see [ME/6506/14 InterCity Railways Limited/ICEC Franchise](#), CMA (2014), paragraphs 193-203.

services, harming competing bus or other transport operators and potentially causing them to be weakened or to exit (network effects).

153. No bus companies (including smaller operators) that the CMA contacted with a specific question about multi-modal or network tickets raised any concerns about rival operators being unable to compete. Third parties that mentioned network ticketing indicated that there were no concerns. A third party noted this partially in relation to an area where Arriva is the only bus competitor (as well as, potentially, operating the Northern Rail franchise) and said that the multi-modal tickets were a very small part of the local market (ie 1.6%).

#### *Conclusion on conglomerate effects*

154. For the reasons set out above, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of conglomerate effects, specifically from the bundling of TPE and FirstGroup local bus tickets.

#### **Barriers to entry and expansion**

155. 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>60</sup>
156. 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. However, given that the CMA in any event considers it appropriate to exercise its discretion to apply the markets of insufficient importance exception to the duty to refer, it is not necessary to conclude on barriers to entry and expansion.

#### **Third party views**

157. The CMA contacted customers and competitors of the Parties as well as other interested third parties including industry bodies. One transport group raised concerns regarding the impact on the sale of its multi-modal ticketing scheme of a potential FirstGroup ticket offer (which was considered by the CMA in paragraph 153 above on conglomerate effects). No other third parties raised concerns about the Franchise Award.

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<sup>60</sup> [Merger Assessment Guidelines](#), from paragraph 5.8.1.

158. Third party comments have been taken into account where appropriate in the competitive assessment above.

## Conclusion on substantial lessening of competition

159. Based on the evidence set out above, the CMA cannot rule out that the Franchise Award may be expected to result in an SLC as a result of horizontal unilateral effects in relation to bus-on-rail overlaps on the Huddersfield–Marsden overlap.

## Exceptions to the duty to refer

160. 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 markets 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 apply the *de minimis* exception to the present case.
161. The Parties stated that they were willing to waive their procedural rights to a full investigation, including the receipt of an Issues Letter and an Issues Meeting, in the event that the CMA found that its duty to refer might be met but that it would exercise its discretion to apply the *de minimis* exception. This statement was provided without prejudice to the Parties' views on whether the duty to refer was met.<sup>61</sup> Given that, on the basis of the factors below, the CMA decided to apply this discretion, it did not send an Issues Letter to the Parties and no Issues Meeting was held.

## Markets of insufficient importance

162. 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>62</sup> The CMA will also have regard to the wider implications for future cases of any decision that it takes to exercise its *de minimis* discretion.

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<sup>61</sup> This procedural approach is in line with the [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance \(OFT1122\)](#), December 2010 – see paragraph 2.53. This guidance has been adopted by the CMA (see Annex D to [Mergers: Guidance on the CMA's Jurisdiction and Procedure](#)).

<sup>62</sup> [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), chapter 2.

### *'In principle' availability of undertakings in lieu*

163. The CMA's general policy, regardless of the size of the affected market, is not to apply the *de minimis* exception where clear-cut undertakings in lieu of a reference could, in principle, be offered by the parties to resolve the concerns identified.<sup>63</sup>
164. In most cases, a clear-cut undertaking in lieu will involve a structural divestment. The CMA considered whether the Parties could have divested the overlapping bus services on the Huddersfield–Marsden flows. However, in line with its prior decisional practice, the CMA believes that the divestment of individual flows is unlikely to be clear-cut, proportionate or effective to address the competition concerns identified. In particular, the buses operating on the flows concerned represent less than 30% of the bus route revenue but in order for divestment of individual flows to be viable and effective other assets such as a suitably located depot, drivers and vehicles may also need to be divested, impacting on the remainder of the route.<sup>64</sup>
165. Accordingly, the CMA does not consider that an 'in principle' clear-cut undertaking in lieu is available in this case.

### *Relevant factors*

166. The CMA will consider the likely level of consumer harm by reference to a number of factors when deciding whether or not to apply the *de minimis* exception: the size of the market, the strength of the CMA's concerns that harm will occur as a result of the merger, the magnitude of competition that would be lost by the merger, and the likely durability of the merger's impact.<sup>65</sup> The CMA will also consider the wider implications of a *de minimis* decision.<sup>66</sup> Each is considered in turn below.

### *Market size*

167. The total revenue of the Huddersfield–Marsden flows on which the CMA found a realistic prospect of an SLC in this case amounts to less than £1 million per annum. This is significantly less than the £10 million threshold above which *de minimis* will not be applicable, and the £3 million threshold

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<sup>63</sup> [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), paragraphs 2.2 and 2.18-27.

<sup>64</sup> See CMA Case [ME/6226/13 Arriva/Centrebus](#) (6 May 2014), paragraph 111. The CMA will take a conservative approach to assessing whether undertakings in lieu are in principle available, as noted in [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), paragraph 2.27.

<sup>65</sup> [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), paragraph 2.28.

<sup>66</sup> [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), paragraph 2.40-43.

below which the CMA will generally not consider a reference to be justified.<sup>67</sup> The relatively small size of the market is therefore a strong factor in favour of application of the exception.

#### *Strength of the CMA's concerns*

168. Although the Parties' share of supply in both bus and rail services is high, the CMA notes the presence of three other bus operators who are active on this flow in the Huddersfield area (see paragraph 146 above). The CMA does not therefore believe that the strength of its concerns in this case would be an aggravating factor for the purposes of its *de minimis* assessment.

#### *Magnitude of competition lost*

169. As noted above, the CMA considers 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. Therefore, the magnitude of competition lost as a result of the Franchise Award is lower compared to the loss of a competitor with the same mode of transport. In addition, as other competitors (in both bus and rail) are active in the area, the threat of entry by these competitors could potentially constrain the Parties, at least to limit the impact of any SLC that occurs as a result of the Franchise Award.
170. On balance, therefore, the magnitude of competition lost as a result of the Franchise Award does not lead the CMA to consider it to be an aggravating factor for the purposes of its *de minimis* assessment.

#### *Durability*

171. Although competitors have not stated that they will enter on a particular route or extend their services, as discussed above, there are a number of competitors active in the Huddersfield area, which could limit the durability of the potential harm. This factor would therefore not point against the exercise of the *de minimis* discretion.

#### *Replicability*

172. Replicability is a factor that may count towards not applying the *de minimis* exception.<sup>68</sup> However, in the present case the CMA does not consider this to

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<sup>67</sup> [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), paragraph 2.2.

<sup>68</sup> The OFT will be less likely to apply the *de minimis* discretion where it believes that the merger in question is one of a potentially large number of similar mergers that could be replicated across the sector in question. See [Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance](#), paragraph 2.40.

outweigh the strong factors in favour of applying this exception, as set out above and the CMA considers that, even taking account of replicability, a reference to a Phase 2 investigation would not be justified.

### *Conclusion on the application of the de minimis exception*

173. Taking all the above factors into consideration, the CMA believes that the market concerned in this case is not of sufficient importance to justify the making of a reference. As such, the CMA believes that it is appropriate for it to exercise its discretion to apply the *de minimis* exception.

## **Decision**

174. Consequently, the CMA has not had to conclude on whether 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 as, pursuant to section 33(2)(a) of the Act, the CMA believes that the markets concerned are in any event not of sufficient importance to justify the making of a reference.

175. The Franchise Award will therefore **not be referred** under section 33 of the Act.

**Jonathan Parker**  
**Director of Mergers**  
**Competition and Markets Authority**  
**14 March 2016**

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<sup>i</sup> As regards paragraph 33, FirstGroup wishes to note that in its original submission it identified both 400 m and 1,200 m catchment areas for all overlap flows. At the CMA's request, FirstGroup then checked that no additional overlaps would occur on a settlement basis. In classifying areas as urban or inter-urban the CMA's choice of whether to use the 400 m or 1,200 m catchment was mainly based on the individual bus route and total flow length.

<sup>ii</sup> In relation to footnote 29, FirstGroup wishes to note that the specific flow in question is Manchester Victoria to Warrington; however, at this stage of the analysis the flows to different central Manchester stations were not combined so, on a cautious basis, this flow included all revenue from Central Manchester (BR code) stations to Warrington. This revenue had also been included in other Manchester to Warrington flows that were not filtered out by this step.

<sup>iii</sup> In relation to footnote 46, FirstGroup wishes to note that the highest level of commission payable is 9% for sales of tickets through ticket vending machines and ticket offices on the Leeds-Garforth flow.