



# A better bid?

*Bidding for a rail franchise is a complex matter. Here, JEREMY ROBINSON, NIGEL TAYLOR and VINEET BUDHIRAJA from law firm Watson Farley & Williams LLP outline what should be considered from a merger control perspective and how best to respond to invitation to tender questions*

Since March 2013, when the Department for Transport (DfT) announced the new procurement regime for rail franchises in the UK, it has awarded 11 rail franchises, including the concessions granted by Transport for London.

Section 66(3) of the Railways Act 1993 provides that by entering into a rail franchise agreement, a franchisee acquires control of a business<sup>1</sup>, which consequently could amount to a relevant merger situation for the purposes of the UK merger regime<sup>2</sup>. The position would essentially be the same under the EU merger regime. Whether an award of a franchise would be assessed under the EU or UK rules would depend on the turnover of the bidder and the franchise operation in question. Unless the turnover

figures are sufficiently large to meet the higher thresholds of the EU merger regulation, an award of the franchise would be assessed by the Competition and Markets Authority (CMA) under the UK merger regime<sup>3</sup>. Of the 11 franchise awards since March 2013, only the Northern rail franchise award to Arriva Rail North Limited involved a referral back from the European Commission (EC) to the CMA.

This briefing outlines what rail franchise bidders need to consider from a merger control perspective when responding to an invitation to tender (ITT), and how bidders should best respond to ITT questions, pointing out certain practical issues that can arise so that their bids are not prejudiced.



### **ITT – key points**

Generally, the Competition Matters section of an ITT includes the merger control requirements that bidders must include in their bids for the particular franchise. The questions in this section of the ITT can broadly be divided into the following three categories:

- merger strategy of the bidder
- reasoned analysis of the likely competition assessment of the transaction, and
- indicative timetable for securing the required competition clearance.

### **Merger strategy**

Bidders are expected to confirm their merger strategy,

including whether they expect the award of the franchise would require a notification to the EC, and, if so, whether they would submit an Article 4(4) of the EUMR request for the transaction to be referred back to the CMA.

Moreover, bidders are required to propose how they would minimise delay and ensure that commencement and operation of the franchise would fulfil the franchise agreement requirements. This involves bidders: explaining their approach to pre-notification discussions; confirming their willingness to offer undertakings/commitments to avoid a second phase investigation; and confirming that any such undertakings would not impinge on their ability to operate the franchise in question, or any of its existing transport interests.

The questions around willingness to offer undertakings/commitments can sometimes be problematic, especially if they require a bidder to give an open ended commitment<sup>4</sup>. For compliance reasons it might not be possible for a public limited company bidder to offer such a broad undertaking, or the situation might be such that there is no risk of a second-phase investigation, thus making such a broad undertaking unnecessary and unwarranted. In such a scenario, if a bidder, for perfectly good reason, does not offer a broad undertaking as required by the ITT, it might not meet the ITT's requirements<sup>5</sup>.

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*1 Section 66(3) states that: "For the purposes of Part 3 of the Enterprise Act 2002 (merger references), where a person enters into a franchise agreement as a franchisee, there shall be taken to be brought under his control an enterprise engaged in the supply of the railway services to which the agreement relates."*

*2 Award of the Docklands Light Railway franchise and the Crossrail concession by Transport for London were found not to have created a relevant merger situation as the bidders did not have an ability to exercise material influence over the franchise or concession in question.*

*3 Note that even where an award of a rail franchise in the UK would meet the EU merger thresholds, the bidder can submit a referral back request under Article 4(4) of the EU Merger Regulation (EUMR) for the transaction to be assessed by the CMA. The European Commission has rightly accepted every such request in the event of a rail franchise award in the UK as the competition would be affected only within the UK.*

*4 For instance, see page 22 of the ITT for Essex Thameside (published in September 2013).*

*5 By comparison, in the ITT for the Northern Franchise, the DfT seems to have addressed this issue by including an option for the bidders to offer reasoning to support its conclusion that it would not be required to offer such undertakings/commitments.*



### **Competition assessment**

Bidders are expected to provide the DfT with a competitive assessment of the transaction, ie whether the award of the franchise would negatively affect competition in the market. Bidders need to identify the overlaps between their existing transport interests and the franchise operations to do this. In other words, bidders must provide an assessment of full point-to-point flows – both rail-on-rail and bus-on-rail overlaps. In their individual assessments, bidders should include an analysis of journey time, fares (including whether it has an ability to change fares), and competition with other modes of transport such as air, etc.

Bidders should keep in mind that the DfT does not carry out its own competition assessment of the award of a franchise; rather it considers whether the approach that bidders have described is reasonable and in line with the methodology adopted by the CMA in past cases<sup>6</sup>. Moreover, where bidders identify competition problems, they must include an analysis of how they propose to address these, and why they expect that the CMA (or the EC) would accept their arguments.

Technically, the UK operates a voluntary merger regime, ie even if a transaction meets the jurisdictional thresholds, the parties can decide not to notify the transaction to the CMA on account of there not being any substantive overlaps between them (ie absence of any competition

issues). However, in order for rail franchise bids to meet the strict ITT requirements, and also as a matter of good practice, bidders might be expected to make a fail-safe notification to the CMA (or engage with the CMA informally) even where a bidder's existing transport interests and the franchise in question do not overlap.

### **Indicative timetable**

ITTs also require bidders to provide details of the indicative timetable of obtaining a merger clearance to ensure that bidders (if awarded the franchise) would be able to commence operation of the franchise without any delay.

To satisfy the requirements of the ITT bidders must indicate:

- the approximate date of notification to the relevant competition authority
- the timing of preparation of notifications and pre-notifications with the relevant authority
- the submission of formal notification, and
- the clearance.

This is to enable the DfT to assess whether the bidders' timetable allows them to obtain necessary clearances before the commencement date of the franchise. It also shows whether the bidders' timetable is realistic in light of the suggested competition assessment.

Bidders do not have to wait until the award of a



franchise to begin pre-notification discussions with the competition authorities. The CMA encourages bidders to enter into pre-notification discussions with it soon after bid submission. However, the CMA will conduct a formal investigation only into the winning bid; pre-notification discussion with all bidders ensures that the investigation timetable begins the moment the winning bid is announced. Moreover, the CMA expects that the bidders should commence pre-notification discussions four to six weeks before the expected award date of the franchise<sup>7</sup>. Bidders also have to assess, where applicable, the impact of the possible requirement to notify the EC, and consequent referral back request under Article 4(4) of the EUMR, on the indicative timetable. Any dealings with the EC would inevitably lengthen the timetable of obtaining a competition clearance.

### **Comment**

It is imperative for rail franchise bidders to include merger control in their initial assessment of their bids. This allows bidders to anticipate any potential competition problems and address them in a timely manner, and to provide the DfT with sufficient evidence of this.

If the DfT thinks that awarding a franchise could invite CMA (or EC) intervention, to the extent that it prejudices that bidder's ability to commence operation of the franchise on the proposed start date, or to operate the

franchise as bid, it will at the least mark down the bidder's bid. At worst, the DfT may decide to disqualify the bid.

Bidders should ensure they address every requirement listed in ITTs even if, considering specific circumstances, a particular requirement may be irrelevant, or inappropriate – for instance, as noted above, the requirement to give extremely broad undertakings under the ITT for the Essex Thameside franchise. ■■

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*6 The Office of Rail and Road (ORR) has concurrent jurisdiction with the CMA in relation to prohibitions against anti-competitive agreements and abuse of a dominant position, including making certain market investigation references. However, the ORR's concurrent powers do not extend to merger investigations in the UK. In the Memorandum of Understanding signed by both regulators on 9 February 2016, they jointly acknowledge the importance of discussing and sharing information, so as to maintain impartiality and fairness, but it is made clear that the CMA's role in merger investigation is entirely separate.*

*7 See Page 1, Rail Franchises: Q&As (published by the CMA in March 2014).*