

WATSON FARLEY & WILLIAMS

BRIEFING

CONSULTATION ON UPDATED GUIDANCE FOR ASSESSING RAIL FRANCHISE AWARDS NOVEMBER 2017

- THE COMPETITION AND MARKETS AUTHORITY ("CMA") CONSULTS ON THE ASSESSMENT OF UK RAIL FRANCHISE AWARDS
- THE DEADLINE TO RESPOND IS 17:00 ON 18 DECEMBER 2017



On 18 October 2017, the UK's Competition and Markets Authority ("CMA") announced a consultation on a general guide for franchise bidders and a technical guide on the methodology for assessing rail sector mergers. These guides set out existing CMA decisional practice and build on existing guidance for rail franchise bidders on the assessment and procedure for UK merger clearance. The deadline to respond to the consultation is 18 December 2017.

Under section 66(3) of the Railways Act 1993, a franchisee entering into a rail franchise agreement acquires control of a business. This acquisition of control may amount to a relevant merger situation under the UK merger control regime. The CMA, therefore, has a statutory role in reviewing franchise awards.

Our previous briefing on the "Award of rail franchises in the UK - merger control implications" sets out the competition law considerations for bidders of rail franchise tenders in the UK.¹

The main points from the draft guidance texts are outlined on the following pages.

¹ This briefing can be found [here](#).

“THE DRAFT GENERAL GUIDE ENCOURAGES ALL BIDDERS TO ENTER INTO PRE-NOTIFICATION DISCUSSIONS WITH THE CMA AFTER SUBMITTING THEIR BIDS.”

1. Rail franchise guide for potential bidders²

Pre-notification

The draft general guide encourages all bidders to enter into pre-notification discussions with the CMA after submitting their bids. Bidders should begin formal pre-notification four to six weeks before the expected date of the franchise award.

Pre-notification involves bidders submitting a draft merger notice to the CMA. If the bidder is awarded the franchise, a final merger notice needs to be provided to the CMA.

To assist the preliminary analysis, the CMA’s guide further encourages bidders to discuss with it what information should be included in the merger notice concerning the overlaps between the bidder’s other transport services (bus, coach, and train) and the rail franchise route. Where there are no overlaps, under the voluntary merger regime in the UK, the bidder *may* decide not to notify the CMA of the franchise award.³

Phase 1: impact on franchise timetable

Once a complete merger notice has been submitted, the CMA has 40 working days to review the transaction’s impact on competition (this is known as the Phase 1 inquiry). As part of this process, the CMA will seek the views of local authorities, competitors and customer groups. The franchisee will receive a state of play update around 15 to 20 days into the investigation. If the CMA identifies any competition concerns, it will convene an “issues meeting” with the franchisee at around day 25 of the inquiry.

Phase 2: undertakings in lieu

If the CMA has concerns about the franchise award, the franchisee may offer undertakings in lieu of the Phase 2 inquiry being initiated.⁴ As early as the pre-notification period, the bidder should start thinking about possible undertakings it might offer in lieu of a Phase 2 inquiry. This will increase the chances of the undertakings being accepted at the end of the Phase 1 inquiry.

Initial enforcement orders

The CMA has the power to impose initial enforcement orders (“IEOs”) for anticipated and completed mergers. These IEOs require the merging parties to hold their business activities separate during the investigation period – in rail franchise awards this will only apply where the CMA is not able to conclude the merger investigation before the start of the franchise. An IEO will not prevent a franchisee from meeting its obligations under the franchise agreement.⁵

² CMA, *Rail Franchises: A guide for potential bidders*, click [here](#).

³ Where the winning bid meets the jurisdictional thresholds under the EU Merger Regulation it must notify the European Commission about the merger.

⁴ For instance, in 2017, in relation to the award of the South Western Franchise, the CMA accepted a fare cap on routes between London and Exeter in lieu of a Phase 2 inquiry. Also note that generally the invitation to tender would require a bidder to offer these undertakings.

⁵ For example, Arriva commenced the operation of the Northern franchise during the CMA’s Phase 2 inquiry in 2016.

“UNDER THE DRAFT GUIDANCE ON THE METHODOLOGY FOR ASSESSING RAIL FRANCHISE AWARDS, THE CMA PROPOSES DIFFERENT APPROACHES FOR RAIL TO RAIL AND BUS TO RAIL OVERLAPS.”

2. CMA Methodology guidance⁶

Under the draft guidance on the methodology for assessing rail franchise awards, the CMA proposes different approaches for rail to rail and bus to rail overlaps. For bus to rail overlaps (which are more sensitive to price increases and service degradation) the CMA focuses generally on changes to bus services.

Market analysis

Rail travel will be the starting point for the relevant market analysis and then other demand-side substitutes (for example, coach routes, bus routes or private conveyance). The CMA will consider the available route options on a particular journey, the cost, the journey and connecting times, and the frequency of the available travel.

In evaluating the geographic market, the draft guidance sets out that the CMA will assess the flows of travel between two points. The CMA considers overlapping flows as rail services between two stations, coach and rail services between the same two settlements, and bus and rail services where the catchment area of a rail service has bus stops.

Counterfactual

As part of its substantive analysis, the CMA evaluates whether the merger will result in a substantial lessening of competition on the market. To do this it will consider what may happen in the absence of the merger (the counterfactual situation).

In most cases, the relevant counterfactual is the existing pre-merger conditions. However, this is not the case for rail franchise awards where the current rail franchise agreement is due to terminate (there cannot be an expectation that the same operator will continue to run the franchise).⁷

When assessing the rail franchise award, the CMA will generally use the counterfactual of a franchise awarded to a train operating company that raises no competition concerns.

Joint ventures

When assessing joint ventures, the CMA will look at each joint venture on a case-by-case basis. As part of the analysis, the CMA will want to find out how each joint venture partner sets fares and ensures quality. Equally, the CMA will examine how far the franchise operates independently of its joint venture partners.

Filters

Where there are a large number of overlapping flows, the CMA will apply filters to prioritise which flows are likely to generate competition concerns. For bus-on-rail overlaps, the CMA will apply filters based on revenue data. Where there is an overlap of two or more bus routes, the CMA may combine the revenues of routes before applying the filter. For rail-on-rail overlaps, the CMA will typically filter out

⁶ CMA, *Rail franchise mergers: Review of methodologies and guidance*, [click here](#).

⁷ CMA, *Rail franchise mergers: Review of methodologies and guidance*, para. 5.1.

“THE CMA IS INVITING RESPONSES TO THE TWO GUIDELINE DOCUMENTS. THE DEADLINE FOR DOING SO IS 17:00 ON 18 DECEMBER 2017.”

flows where it is clear that that the franchisees’ rail services are not realistic alternatives for passengers.

Competitive assessment

For bus-on-rail overlaps, the CMA will focus on the competitive constraint of the overlapping bus market. The CMA will look at the ability and incentive for the bus operator to increase prices or offer a lesser standard of service as a result of the rail merger.

For rail-on-rail overlaps, the CMA will focus primarily on the ability to increase ticket prices and will distinguish between regulated and unregulated fares. The CMA will use MOIRA (model of inter-regional activity) to test the level of substitutability of overlapping rail services.

The CMA will also consider other constraints, such as the possibility of third party entry and expansion, providing that this entry and expansion is timely and sufficient to offset any competitive concerns. The draft methodology guidance notes that the barriers to entry or expansion on rail services are high, but may be lower for bus services. The analysis will therefore involve looking at bus companies in the area and their intention and capacity for expansion.

3. Next steps

The CMA is inviting responses to the two guidance documents. The deadline for doing so is 17:00 on 18 December 2017.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.



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Publication code number: 61107370v1 © Watson Farley & Williams 2017

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