

Anticipated acquisition by Inter City Railways Limited of the ICEC Franchise

Introduction

1. On 27 November 2014 the Department for Transport (**DfT**) announced that the InterCity East Coast rail franchise (**ICEC** or the **ICEC Franchise**) had been awarded to Inter City Railways Limited (**ICRL**) (the **Franchise Award**), a subsidiary of Stagecoach Group plc (**Stagecoach**) and the Virgin Group Holdings Limited (**Virgin**). On 6 February 2015 the Competition and Markets Authority (**CMA**) decided under section 33(1) of the Enterprise Act 2002 (the **Act**) that it believes that it is or may be the case that the Franchise Award may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom (the **SLC Decision**).
2. On 13 February 2015, Stagecoach offered undertakings to the CMA for the purposes of section 73(2) of the Act. As required under section 73A(1) of the Act, Stagecoach made this offer within five working days beginning the working day after the CMA notified it of the SLC decision under section 34ZA(1)(b) of the Act. The CMA now gives notice, pursuant to section 73A(2)(b) of the Act, to Stagecoach that it considers that there are reasonable grounds for believing that the undertakings offered, or a modified version of them, might be accepted by the CMA under section 73(2) of the Act and that it is considering the offer.

The undertakings offered

3. Under section 73(2) of the Act, the CMA may, instead of making a reference for a phase 2 investigation, and for the purpose of remedying, mitigating or preventing the substantial lessening of competition concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the parties concerned as it considers appropriate undertakings to take such action as it considers appropriate.
4. The CMA in the present case identified competition concerns in regards to the following overlap flows:

- (a) the overlap of ICEC rail services with East Midland Trains services (EMT) operated by East Midlands Trains Limited, a subsidiary of Stagecoach, between Peterborough and Grantham and between Peterborough and Lincoln; and
 - (b) the overlap of ICEC rail services with coach services that are operated and jointlyⁱ owned by Citylink, in which Stagecoach has a 35% interest, between Edinburgh and Dundee as well as between Edinburgh and Aberdeen.
5. Stagecoach has offered the following undertakings in relation to each of these overlaps.

Lincoln–Peterborough

6. The proposed undertaking will commit Stagecoach to retaining the current EMT dedicated fare and prohibit it from increasing the dedicated fare by more than is permissible for price increases to fare baskets in the EMT franchise agreement. In this way the undertaking aims to remove Stagecoach's ability to remove or significantly increase the EMT dedicated fare on this flow.
7. The proposed undertaking will be monitored by the CMA through reports to be provided by Stagecoach at each fare setting round detailing, in particular, any changes to dedicated fares on the flow. These monitoring reports will also be sent to the relevant DfT franchise manager.

Peterborough–Grantham

8. Stagecoach will commit to maintaining the current competitive constraint on this flow by continuing to manage EMT services on the flow as part of the wider Peterborough–Nottingham segment, and not to worsen its offer on this flow relative to that wider segment. The Peterborough–Nottingham segment is commercially a materially more significant flow, generating around seven times the revenue of the Peterborough–Grantham flow.
9. More specifically, Stagecoach will undertake that EMT dedicated fares on the Peterborough–Grantham flow will be offered at the same price point groups¹ and for the same number of seats within these groups as dedicated fares on the Peterborough–Nottingham flow.

¹ As part of its yield management system, Stagecoach specifies the number of seats available at a particular fare point on a particular point to point flow.

10. Stagecoach will also commit to introducing a cap on the level of any increase in the EMT dedicated fare on this flow. The cap will prohibit increases in the dedicated fare on the Peterborough–Grantham flow that are greater (in percentage terms) than increases in the corresponding price point group for EMT dedicated fare on the Peterborough–Nottingham flow.
11. The proposed undertaking will be monitored by the CMA through reports to be provided by Stagecoach at each fare setting round detailing, in particular, any changes to dedicated fares on the flow and providing information about the number of seats in each price point group. These monitoring reports will also be sent to the relevant DfT franchise manager.

Edinburgh–Aberdeen and Edinburgh–Dundee

12. Stagecoach has agreed in principle with the majority shareholder of Citylink, ComfortDelGro, to make structural changes to the joint venture arrangements to grant ComfortDelGro sole control over all material operations of Citylink services on these two flows in order to remove Stagecoach’s ability to weaken Citylink as an effective competitor to ICEC on these flows.
13. Stagecoach will commit to secure changes to the decision making and corporate governance structure of Citylink so that all decisions relating to fares, frequency of service, timetable and quality of service are board-reserved matters and are taken only by Citylink directors nominated by ComfortDelGro. To ensure that this is achieved in a clear-cut manner, Stagecoach will commit to abstain from voting on any of these matters.
14. The proposed undertaking will be monitored by the CMA through reports to be provided by Stagecoach twice a year detailing material changes to the relevant Citylink services and confirming that the decision-making process has been consistent with the terms of the undertakings.

The CMA’s provisional views

15. The CMA considers that the undertakings proposed by Stagecoach are likely to provide as comprehensive a solution as is reasonable and practicable to the competition concerns identified by the CMA in its SLC Decision.
16. The particular characteristics of rail franchise awards (including the presence of regulation and restrictions on the operation of rail services provided for in the franchise agreements themselves) can be distinguished from mergers in other industries in a number of ways. The existence of a well-established regulatory framework and the existence of suitable benchmarks provide an

effective mechanism for the capping of rail fares as proposed by the undertakings in the present case.

17. In addition, the specific circumstances of the present case are likely to provide a clear-cut, proportionate and effective remedy to the competition concerns identified.
18. With regard to the Lincoln–Peterborough and Peterborough–Grantham flows the CMA notes that they are each among the smallest flows on both the ICEC and EMT networks.² Given the very small scale of these flows and the indivisibility of rail franchise awards it would not have been feasible to identify a proportionate structural solution to the competition concerns arising in relation to these flows.
19. With regard to the Edinburgh–Aberdeen and Edinburgh–Dundee flows, Stagecoach proposes to make structural changes to the Citylink joint venture agreement with ComfortDelGro and the corporate structure governing the direct overlapping Citylink coach services on which the CMA identified competition concerns. The SLC Decision identified competition concerns that Stagecoach, through its ability to materially influence the policy of Citylink, could weaken Citylink as an effective competitor against ICEC, potentially through service levels not being enhanced or prices not being lowered on the coach services concerned. The proposed undertakings address these concerns by preventing Stagecoach from voting on all material matters affecting Citylink services on these flows, for example fares,³ timetables, frequency and quality of services, that would impact on the competitiveness of the Citylink services as against ICEC.
20. In the specific circumstances of the case, taking into account that Stagecoach is a minority shareholder in the coach operations and that Scotrail and Cross Country are present as competitors on the these flows, the CMA considers that the proposed undertakings are likely to provide a clear-cut, proportionate and effective remedy to the competition concerns identified and are capable of ready implementation given the in principle agreement of ComfortDelGro.

² Lincoln–Peterborough generated [0.001–0.1]% of the total ICEC revenue and [0.001–0.1]% of the total EMT revenue and Peterborough–Grantham generated [0.001–0.1]% of total ICEC revenue and [0.001–0.1]% of total EMT revenue.

³ The determination of fares for tickets for direct services on these two flows sold through the megabus.com website (or any other megabus branded channel) shall not be a reserved board matter. Only a small proportion of seats for Citylink branded coaches sold on these flows (generally [0–10] seats out of [55–65] seats on each coach) are sold through the megabus website and are yield managed. For megabus branded coaches the position is reversed, with [55–65] seats sold through megabus.com and only [0–10] sold through Citylink channels. Pricing on megabus.com is the responsibility of Citylink management, in consultation with the megabus.com yield management team. It would be impractical and commercially burdensome for decisions on yield managed megabus fares to require prior board approval as megabus fares are, by their nature, dynamic and can potentially change regularly within the yield management system.

Consultation process

21. Full details of the undertakings offered will be published in due course when the CMA consults on the undertakings offered as required by Schedule 10 of the Act.⁴

The decision

22. For the reasons set out above, the CMA considers that there are reasonable grounds for believing that the undertakings offered by Stagecoach, or a modified version of them, might be accepted by the CMA under section 73(2) of the Act. The CMA now has until 21 April 2015 pursuant to section 73A(3) of the Act to decide whether to accept the undertaking, with the possibility to extend this timeframe pursuant to section 73A(4) of the Act if it considers there are special reasons for doing so. If no undertaking is accepted, then the CMA will refer the Franchise Award pursuant to sections 33(1) and 34ZA(2) of the Act.

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20 February 2015

ⁱ In paragraph 4(b) the CMA wishes to note that the reference to coach services being 'jointly' owned by Citylink is inaccurate and should be disregarded as Citylink solely owns and operates the coach services.

⁴ *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2, January 2014), paragraph 8.29.