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## Anticipated acquisition by First Group plc of GB Railways plc

The OFT's decision on reference under section 33 of the Enterprise Act given on 30 September 2003

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### PARTIES

**First Group plc** (First) operates three train operating companies (TOCs) in the UK: First Great Western, First Great Eastern (FGE) and First North Western. First is also the largest bus operator in the UK and operates bus services in the South East and East Anglia via First Essex (FE) and First Eastern Counties (FEC). First failed to make the shortlist for the Greater Anglia franchise which is due to be awarded by the Strategic Rail Authority (SRA) in April 2004, but is shortlisted for the Northern Rail franchise. In the year to end March 2003, First reported a turnover of £2.3 billion of which approximately £1.7 billion was generated in the UK. **GB Railways Group plc** (GB Rail) operates one rail freight franchise (GB Railfreight) and two TOCs (Anglia Railways and Hull Trains). GB Rail has been shortlisted by the SRA for the Greater Anglia and Northern Rail franchises. In the year to end March 2003, GB Rail reported a preliminary turnover of £92.1 million – all of which was generated in the UK.

### TRANSACTION

First intends to acquire 100 per cent of the issued share capital of GB Rail by way of a public offer. The transaction was announced on 16 July 2003. 50 per cent of the consideration is conditional on GB Rail successfully tendering for the following franchises: Greater Anglia, Northern Rail, and Wales and the Borders. Arriva has been selected as preferred bidder for the Wales and the Borders franchise, hence this aspect of the consideration falls away. The transaction was notified as an informal submission on 5 August 2003.<sup>1</sup> The administrative deadline for a decision is 30 September 2003.

### JURISDICTION

As a result of this transaction First and GB Rail will cease to be distinct. The UK turnover of GB Rail exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act) is satisfied. A relevant merger situation will be created.

### COMPETITION ASSESSMENT

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<sup>1</sup> The parties wish to point out that the transaction was declared unconditional in all respects on 14 August 2003.

The activities of First and GB Rail overlap in the provision of passenger transport services in the Anglia region. Here, the parties' rail services overlap on the London to Colchester and Ipswich line. There are also 35 point-to-point overlaps between First's bus services and GB Rail's rail services; these overlaps affect parts of Essex, Suffolk, Cambridgeshire and Norfolk.

### **Rail/Rail**

The SRA is remapping the Anglia and Great Eastern franchises into one large franchise with effect from April 2004. At present, these two franchises overlap on the London to Ipswich route; competition between the Great Eastern franchise and the Anglia franchise on this route will therefore be eliminated by the SRA's remapping exercise. Any lessening of competition that may arise as a result of the remapping exercise cannot be investigated as a relevant merger situation by the OFT, although the remapping does form part of the counterfactual against which to assess the merger between First and GB Rail.

As noted above, the Great Eastern franchise is currently operated by First and the Anglia franchise by GB Rail. Accordingly, the merger will result in the elimination of competition between First and GB Rail on the London-Ipswich route served by both franchisees. However, since the Anglia and Great Eastern franchises are to be remapped together in any event, the merger seems unlikely to lead to any lessening of competition over and above that caused by the remapping exercise, particularly in circumstances where First has not been shortlisted as a potential bidder for the combined Greater Anglia franchise. Although there will be an interim period of a few months between completion of this transaction and the award of the combined Greater Anglia franchise, this seems too limited a period to enable the merged entity to alter its rail services to take advantage of any enhanced market power.

In the national context, the merger will result in the loss of a bidder for rail franchises. However, a number of other franchise bidders including National Express Group, Arriva, Serco, Go Ahead Group and Stagecoach, will remain. There are also potential bidders not currently represented in the UK such as Eurailco UK, which has been shortlisted for the new Northern franchise. As a result, the merger is unlikely to result in a substantial lessening of competition for future rail franchises in the UK and this aspect of the merger will not be considered further.

### **Bus/Rail**

#### **Product Market**

Passengers' choice of mode of transport on a point to point journey depends on a number of factors including access to a particular means of transport, personal preference, their value of time, and the relative costs of the available alternatives. These factors are likely to be relevant when passengers are choosing between bus and rail options for broadly the same journey. In this respect, bus services tend to be more frequent and cheaper than comparable rail options, although bus journeys tend to be longer because of the often less direct route taken and the greater number of stops.

The extent to which prices and/or service on bus or rail services are constrained competitively by one another is not clear. Previous CC merger investigations<sup>2</sup> have considered that a degree of competition between bus and rail does exist on specific routes. The conclusions of these studies are, however, not entirely relevant to this case since the last investigation of bus/rail issues was conducted some time ago (in 1997) and the conclusions of those investigations are based on factors specific to the routes considered by the CC. More recently, a report commissioned by the Department of Transport, the London to Ipswich Multi-Modal Study<sup>3</sup>, examined the options for transport planning within the London to Ipswich area over the next forty years. The evidence gathered by this study suggests that bus or coach passengers who do switch in response to changes in public transport fares are likely to switch to rail transport and cars. Again, this study may not be a good guide to the competitive interaction between bus and rail transport on the 35 identified overlap routes in this case since the Multi-Modal Study was focused largely on commuters to London, whilst the vast majority of the overlap routes under consideration here are much more local in character.

The parties have argued that the different journey characteristics – e.g. journey lengths and location of bus stops in town centres as opposed to rail stations typically on town peripheries – mean that bus and rail serve different groups of customers and as a result, do not constrain each other. First's evidence, however, indicates that passengers are prepared to travel over a mile to reach a train station, and a significant proportion of their passengers used a bus to reach a rail station. This suggests that even though a bus route may start or end in a town centre whereas a rail station is located on the periphery of a town, they may fall within the same catchment area. Furthermore, it suggests that if it is possible to use a bus to reach a destination directly then bus and rail may be suitable alternatives to some degree for some passengers.

Some third parties contacted in respect of this merger believed that competition between these two modes of transport on the 35 overlap routes was limited. Others believed that competition may exist on particular point-to-point overlaps.

The relevant frames of reference for assessing the competitive effects of this merger are considered therefore to be the point-to-point routes where there are overlaps between the parties' services in the Anglia region.

### **Horizontal issues**

The merger will combine the two main transport providers in the region, in particular GB Rail's current Anglia franchise, which provides local train services, with First's local bus operations, which cover about 70 per cent of commercial bus services and about 20 per cent of tendered services in Norfolk and Suffolk. As to the links involved in integrated transport services, some concern was expressed by competing bus operators about the merged entity's ability to restrict access to inter-available ticket schemes.

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<sup>2</sup> Cm 3774, 16 December 1997, National Express Group plc and Central Trains Ltd;  
Cm 3773, 16 December 1997, National Express Group plc and ScotRail Railways Ltd;  
Cm 3495, 20 December 1996, National Express Group plc and Midland Main Line Ltd.

<sup>3</sup> The London to Ipswich Multi-Modal Study, Mott MacDonald, December 2002.

However, the scheme represents a small proportion of the parties' total revenue, so it seems unlikely that the merged entity would find it profitable to engage in such behaviour. Moreover, the Public Transport Ticketing Scheme Block Exemption 2001<sup>4</sup> provides that the exclusion of an operator from a multi-operator scheme except for objective, transparent or non-discriminatory reasons would result in losing the benefit of the exemption.

Of the total 35 routes in the Anglia region where the parties' bus and rail services overlap on point-to-point journeys, there appears to be no other effective competitor on 27 of these routes. (On the eight other routes, there is competition from either Central Trains or Sanders Coaches.) For these 27 routes, it must be considered whether there is a significant prospect that the merger would substantially lessen competition in the event that GB Rail won the Greater Anglia franchise.

The parties have argued that bus and rail services do not compete on the 27 routes. In this connection, they have submitted substantial evidence, including data on passenger journeys, journey durations, routes, fares, and passenger characteristics.

Examination of the overlap routes indicates that although bus services can be cheaper and more frequent than rail services, bus services along the point-to-point overlap routes tend to involve longer journeys and more stops, and as a result, may be considerably less convenient than rail services for many journeys. And revenue and passenger journey data for the parties' bus and rail services indicate that on some of the overlap routes where the bus service is cheaper, more frequent and of similar journey length to the rail service, passenger and revenue numbers are still higher on the rail route. This suggests that on some of the overlap routes customers do not view the two modes of transport as viable alternatives for those routes.

However, on a route such as Norwich to Great Yarmouth, where the bus service is cheaper, more frequent, and has a similar journey length to the rail service, the rail and bus services may be closer competitors. In such circumstances, the merger may give rise to significant competition concerns.

However, there is limited evidence of customers switching between rail and bus services on routes such as this, and the parties' incentive and ability to increase prices or reduce service levels on the overlap routes appear limited. According to the parties, the revenue earned on the 35 point-to-point overlap routes represents [less than 10 per cent of Anglia Railways' and of FEC's total revenue.]<sup>5</sup> In respect of the Norwich to Great Yarmouth route, revenue represents [less than 10 per cent]<sup>6</sup> of each of Anglia Railways' and FEC's total revenue. Secondly, any incentive to gain rail passengers by raising bus fares would seem to be blunted by the fact that the [Anglia rail service

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<sup>4</sup> SI 2001/319.

<sup>5</sup> Commercially sensitive information has been excised and replaced with a range, at the request of the parties.

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revenue is shared with the SRA.]<sup>7</sup> Since their bus passengers are mainly discretionary, off-peak travellers, raising bus fares would likely risk these passengers switching to car transport or not travelling at all. In particular, ownership of the rail service – in the event that GB Rail won the franchise – would seem unlikely materially to affect bus pricing incentives. The parties also argue that it is very difficult to alter prices or frequencies of services so as to target specific customers to switch onto their rail service.<sup>8</sup>

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

Entry for operators onto the national rail network is regulated and licensed by the SRA. Although it is possible to launch new services through Open Access services, these still require approval and are unlikely to be set up by a company not already operating a franchise agreement. Furthermore, the Office of the Rail Regulator (ORR) has also noted that new entry is unlikely given that spare capacity primarily exists in areas of low demand. In these areas, new entrants would need to compete with existing franchises without the benefit of the operating subsidies received by franchise holders. Given these factors barriers to entry for passenger rail services are considered to be high.

In bus services, any new entry would most likely occur along an existing route, and so it would need to be self-financing as it is unlikely that an entrant would receive a Council subsidy. Previous bus investigations have pointed to the importance of the locations of competitor depots in facilitating entry. In the Anglia region, eight out of 15 competitors have depots located within 20 miles of a FEC depot.

Although the reputation effects of competing with the largest bus operator in the region may be significant, third party evidence in this case indicates that competition can occur in such circumstances. Important too in this respect are the effects of the inter-availability of tickets which has been discussed above.

### **Buyer power**

Bus and rail passengers are individual consumers and are not considered likely to hold significant buyer power. Local Authorities who tender council contracts are large customers and as result, may hold significant buyer power; however, this is not so relevant in the context of First's commercial bus operations.

### **Vertical issues**

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<sup>7</sup> The parties have pointed out that GB Railways operates Anglia effectively under a management contract with the SRA and that the revenue sharing agreement is more accurately described as a profit sharing agreement.

<sup>8</sup> Finally, they argue that as the Greater Anglia franchise [only lasts seven years], then driving customers to their rail service would require them to win passengers back to their bus routes if they lose the next bid. [...] – A sentence containing commercially sensitive information has been excised, at the request of the parties. In addition, the parties wish to clarify that the Greater Anglia franchise will be let for a total of 10 years with a break point at year 7 where the final 3 years will be subject to the franchisee meeting specified performance criteria as set out in Schedule 18 of the franchise agreement.

No vertical issues arise from this transaction.

### **Third party views**

Third party enquiries generally indicated a lack of local concern. Concern about access to the inter-available ticket scheme has been addressed above. One large customer indicated that although they did not believe there was any significant competition between bus and rail in Norfolk, the Norwich to Great Yarmouth route, where First offered an express bus service, was the biggest potential issue.

### **CONCLUSION**

This merger is intended to occur ahead of the SRA's remapping exercise to form the combined Greater Anglia franchise for which GB Rail (but not First) is shortlisted. Although the merger will result in a loss of competition on the London-Ipswich rail route before the new franchise comes into effect in April 2004, the interim period is considered to be too short to enable the merged entity to increase fares or reduce service levels. Furthermore, this merger is not considered to have a significant competitive impact on bidding for future franchises in the national context.

From the evidence available in relation to the point-to-point overlaps between the parties' bus and rail services, it appears unlikely that the merger would give rise to significant competition concerns in the event that GB Rail won the combined Greater Anglia franchise. With the possible exception of the Norwich to Great Yarmouth route, the differing characteristics of bus and rail transport are such that, in the area in question, the competitive constraints between bus and rail are unlikely to be strong. Moreover, the revenue generated from the overlap routes is relatively small in relation to the whole, and for rail there is an [incremental revenue sharing agreement with the SRA].<sup>9</sup> Third party enquiries showed little concern in relation to bus/rail competition.

For these reasons, the OFT does not believe that it is or may be the case that the creation of the relevant merger situation may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom for goods or services.

### **DECISION**

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

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<sup>9</sup> See note 7.