NON-CONFIDENTIAL VERSION

ARRIVA PLC

COMPLETED ACQUISITION BY ARRIVA RAIL NORTH LIMITED OF THE NORTHERN RAIL FRANCHISE

INITIAL SUBMISSION TO THE COMPETITION AND MARKETS AUTHORITY FOR PHASE 2 REVIEW

13 JUNE 2016

INDEX

1. INTRODUCTION AND EXECUTIVE SUMMARY

1.1 This is Arriva plc's ("**Arriva**") initial submission to the Competition and Markets Authority ("**CMA**") in relation to the Phase 2 review of its acquisition of the Northern Rail Passenger Franchise (the "**Northern Franchise**") (the "**Transaction**").

1.2 Arriva looks forward to working with the Group Members and the case team on this Phase 2 investigation. It welcomes the opportunity offered by the more extensive Phase 2 timetable to build on the work done in Phase 1 by gathering additional evidence and carrying out a more in-depth analysis of the relevant overlaps. Arriva is confident that this process will enable the CMA to conclude that the Transaction will not result in a substantial lessening of competition ("**SLC**") on any relevant market.

1.3 The investigation concerns two unique and very different industries – bus and rail. This submission describes some of the features of those industries that will set the context for this investigation.

Arriva's rationale for the Transaction

1.4 Arriva's rationale for acquiring the Northern Franchise was not based on any anti-competitive intent.

1.5 The acquisition was driven by a desire to balance Arriva's UK trains portfolio, [✂]. It was also seen as an opportunity to enhance Arriva's reputation as a rail operator and effective bidder following a period of recent relatively unsuccessful bidding.

Rail – competition “for the market”

1.6 The operation of the rail industry in Great Britain today is heavily influenced by the way in which it was privatised in 1994. At that time a franchise model was selected, and repeated competition “for the market” was made the primary mechanism for protecting the interests of passengers.

1.7 This remains true today, although the model has been improved and updated over the years. The current franchise award programme is based on a competitive bidding process, with franchises awarded to train operating companies ("**TOCs**") on a rolling basis for a short to medium term (usually for seven to 15 years). This mechanism protects the interests of passengers in four key ways:

1.7.1 **By regulating fares**. Across the overlapping flows on the Northern Franchise, more than two-thirds of tickets are sold at regulated price points. Such fares are currently frozen in real terms for a five year period.

1.7.2 **By requiring inter-available fares**. Inter-available tickets are tickets that can be used on the services of any operator. Across the overlapping flows on the Northern Franchise, approximately 95% of tickets sold by operators are from inter-available fares.

1.7.3 **By making detailed provision for the services**. Franchise agreements specify the timetables, journey times, and vehicles to be used, as well as almost every conceivable aspect of service quality, including staffing levels, staff training, cleanliness, passenger information etc.

1.7.4 **By stimulating investment and efficiencies**. Bidders for franchise awards are required to specify what investments and service improvements they would make. These are compared as part of the selection process, and the winning bidder commits to those investments and improvements in the franchise agreement.

1.8 This leaves rail operators very limited discretion over how they operate services on a day to day level. The only real discretion relates to those fares outside the scope of the regulatory scheme, but even here the franchise model exerts an influence:

1.8.1 **Regulated fares influence unregulated fares**. They act as a ceiling – for example, an unregulated SuperSaver fare cannot logically exceed the less restrictive and regulated Saver fare on the same journey. They also influence passenger expectations and willingness to pay. In addition, changing unregulated fares on one flow could have unintended consequences on other flows or parts of the network.

1.8.2 **Rail operators like Arriva are highly dependent on the Department for Transport ("DfT")** both in relation to running their existing franchised operations but also in respect of future franchise opportunities. In the context of a rolling programme of awards, operators have a clear incentive to be seen to operate fairly and responsibly. Any attempt to pursue short-term profit opportunities in local areas could have a very detrimental effect on operators' prospects in respect of future franchise awards.

1.9 The franchise system is therefore the primary means by which competition is built in to ensure quality and value for rail passengers. The Phase 1 investigation concluded that there was no realistic prospect of an SLC for the award of rail franchises as a result of the Transaction.

Rail – competition "in the market"

1.10 On some journeys, there is also scope for competition "in the market" (i.e. between providers offering services on the same flow). However, it is important to recognise that the scope for such competition is limited by the franchising model, and plays a subsidiary role to competition for the market. As a result, effective competition is not present on every journey where there is more than one operator. For example:

1.10.1 Passengers have a preference for when they wish to travel, and for shorter, simpler journeys, so many buying decisions will be determined by timetable and route (which franchise operators cannot change unilaterally); and

1.10.2 If a significant proportion of passengers are buying tickets at regulated fares, then there is little price competition.

1.11 The local overlap analysis must therefore avoid an unthinking commitment to separate ownership of all overlapping services. It will instead be necessary to develop a robust methodology to:

1.11.1 Identify journeys on which local competition actually exists and drives benefits for passengers above and beyond those already ensured by the franchise model;

1.11.2 On those journeys, identify the various alternatives available to passengers, including those outside the relevant economic market (as defined). Depending on local circumstances, these may include bus services, coach services, other rail services, driving, park and ride services, taxis/private hire vehicles, cycling and walking;

1.11.3 Understand passenger decision making and the relationships between these alternatives; and

1.11.4 Understand whether or not the acquisition of the Northern Franchise creates incentives for Arriva to alter how it participates in the competitive process.

1.12 It is only by understanding all of this context that any reliable conclusions can be drawn on the impact of the Transaction on competition.

Bus – competition in the market

1.13 As described further below, the bus industry in the Northern Franchise region is characterised by:

1.13.1 Actual competition among bus operators, especially in urban areas, with a wide variety of effective large scale and smaller scale competitors;

1.13.2 Competition from a range of transport options, including driving, taxis/private hire cars, cycling and walking;

1.13.3 A high degree of passenger churn, meaning that bus operators must attract significant numbers of new passengers every year to maintain existing sales, set against a background of long-term decline in passenger demand;

1.13.4 Potential competition among bus operators: bus services are fluid and change regularly to meet shifts in local circumstances and demand. Existing bus operators can enter a new route or expand existing services with only minimal investment - the only requirements for entry are access to vehicles, access to an appropriate depot or operating base, and holding the relevant licences; and

1.13.5 Influential local transport authorities, who have suffered budget cuts over many recent years[1], with an increasing number of voluntary and mandatory mechanisms to control operators' ability and incentives to increase prices or degrade services. The Bus Services Bill, which is expected to enter into force in early 2017, will bring increased regulation, including the ability to franchise bus services and introduce Enhanced Partnerships.

1.14 Arriva has provided a range of evidence indicating that competition from rail services plays only a limited role in decision-making in its bus business:

1.14.1 Arriva's devolved corporate structure: its UK Bus and UK Rail divisions are entirely separate and self-sufficient, [✂]. This demonstrates that it sees no potential advantage from coordinating strategy between the bus and rail divisions; and

1.14.2 Internal documents with limited discussion of overlapping rail services in strategy and management meetings in the bus business.

1.15 While it is important to carry out a thorough review of bus-on-rail overlaps, it is necessary to do so with the industry context in mind. There can be no assumption that any overlapping bus and rail services necessarily compete, or that such competition is material given the range of other constraints operating on the bus business, or that Arriva would have any incentive to coordinate its strategy across those bus and rail services. Each of these steps will need careful examination before any conclusions can be drawn as to the likely impact of the Transaction at a local level.

2. ARRIVA

2.1 Arriva, part of Deutsche Bahn AG ("**Deutsche Bahn**"), is one of the largest providers of passenger transport in Europe, employing more than 55,000 people and delivering more than 2.2 billion passenger journeys across 14 European countries each year.

2.2 In the UK, Arriva operates the Chiltern, Cross Country and Arriva Trains Wales rail

[1] Subsidised services have been cut by 25% since 2004.

franchises, as well as concession contracts for the London Overground and Tyne and Wear Metro. It operates open access services through Grand Central, and is exploring further open access options through its Alliance Rail business. It also operates a range of bus services under its Yorkshire and North East, North West and Wales, Midlands and The Shires, Southern Counties and London bus operations.

2.3 As noted above, Arriva’s management structure is devolved: its UK Bus and UK Rail divisions are entirely separate and self-sufficient, [✂]. Individual TOCs and companies providing passenger bus services in relevant areas are separate corporate entities within those divisions. A structure chart is provided at **Annex 1**.

3. THE NORTHERN FRANCHISE

3.1 Arriva has been appointed to provide passenger rail services in connection with the Northern Franchise pursuant to a franchise agreement entered into between the Secretary of State for Transport and Arriva Rail North Limited ("**ARN**") on 22 December 2015 (the "**Franchise Agreement**"). The franchise term runs for the period from 1 April 2016 to 1 April 2025 and can be extended by up to one year by the Secretary of State**.**

3.2 The Northern Franchise consists of a relatively dispersed[2] series of passenger rail services. The services are a combination of regional, intercity and longer distance services in the North of England provided for leisure, commuter and business use. A number of these are routes to remote areas attracting few passengers[3], and are therefore offered on a subsidy basis by the Secretary of State.

4. THE TRANSACTION

4.1 The Northern Franchise was awarded to ARN following a complex and competitive tendering process. Arriva understands that three bidders participated in all stages of the process: Abellio, Govia and Arriva itself.

4.2 Arriva sets out at **Annex 2** a chronology of events leading up to the award of the franchise and details of negotiations with the DfT.

4.3 Bidders presented comprehensive proposals for running the business, including financial plans and plans for improvements that they could introduce to the service. These proposals were analysed in detail by the Secretary of State for Transport with Arriva's bid representing the best value overall selected for the award.

4.4 Arriva provides at **Annex 3** an overview of Arriva, ARN and the Arriva Businesses overlapping with ARN's activities, together with chronologies of significant events in the last five years.

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[2] The relatively dispersed nature of the Northern Franchise is evident from industry statistics produced by the Office of Rail and Road. The Northern Franchise is only the fifth largest in terms of passenger journeys, accounting for just over 6% of total journeys but is the third largest franchise in terms of train kilometres, accounting for approximately 9% of passenger train kilometres. http://orr.gov.uk/__data/assets/pdf_file/0015/22056/passenger-rail-usage-2015-16-q4.pdf

[3] By way of example, 66 of the 463 stations under management in the previous franchise agreement had fewer than 10,000 entries and exits during 2012/2013 i.e. fewer than about 200 per week. See Northern Prospectus, Section 4.7.

5. **RATIONALE FOR THE TRANSACTION**

5.1 Arriva's rationale for bidding for and acquiring the Northern Franchise was to:

- Develop its rail operations in Great Britain, in particular as a number of the rail franchises currently operated by Arriva in Great Britain are due for re-tendering in the next few years;
- End a period of relatively unsuccessful franchise bidding and enhance its reputation as an operator and bidder;
- Deliver value through a much improved travelling environment and customer experience for passengers; and
- Balance its risk portfolio. [✂].

5.2 [✂] However, it was at no point any part of Arriva's strategy in bidding for the Northern Franchise to benefit from reduced competition on existing rail or bus services overlapping with Northern services. There was no involvement from the UK Bus division in the decision to bid for the Northern Franchise.

6. **THE RELEVANT MARKETS**

Competition for the market: product and geographic scope

6.1 The CMA has previously defined the relevant market as the award of rail franchises on a national basis. Arriva sees no reason to depart from this approach in the present case.

Competition in the market: product scope

6.2 The parties overlap in the provision of passenger transport services in parts of the UK, including bus and rail services[4]. Arriva does not consider that it will be necessary to reach a general conclusion on the scope of the relevant product markets, as the more extensive Phase 2 timetable will allow for detailed individual analysis of individual overlaps raising potential concerns.

6.3 However, as a general point, Arriva draws the CMA's attention to the increasing importance of private transport (e.g. taxis/private hire vehicles, private car, cycling) as a constraint on public transport. Uber is now available across the area covered by the Northern Franchise, including in Leeds, Manchester, Merseyside, Newcastle, Sheffield and Sunderland. Uber has significant capabilities to disrupt existing transport models, for example by launching its bus style service, UberHop. These constraints play an important role in competition and need to be properly taken into account in the CMA's analysis.

6.4 Finally, Arriva generally agrees with the CMA's assumption that competition is closer between the same modes of public transport: that is to say, rail competes more directly with rail and bus competes more directly with bus[5]. However, this may vary according to the particular local circumstance and a range of factors may influence passenger choice, including distance, price, journey time and frequency and directness of services.

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4 CMA Phase 1 Decision, para.115.
5 CMA Phase 1 Decision, para. 34.

Competition in the market: geographic scope

6.5 As passengers travel between a specific point of origin to a specific point of destination (i.e. a point to point journey), the demand is therefore for travel between two points. Arriva agrees that it is appropriate to define a geographic range for the purposes of a local overlap analysis, but notes that competition from services outside that range should not be ignored. It may also be appropriate to define different geographic ranges depending on whether the services operate in urban or rural areas, or based on different journey characteristics (e.g. length/duration). The precise scope of such geographic ranges will be covered in separate submissions and is not discussed further here.

Competition in the market: local competition

6.6 It will also be critical for the CMA to consider local competition and any changes to it within the wider context, including the relevant regulatory framework and the broad range of transport options that passengers have available to them (which are described in the following sections).

7. RAIL REGULATION

7.1 Rail operators in Great Britain can operate under three different models: rail franchises, concession agreements and open access.

7.2 The following Arriva rail businesses currently overlap with the Northern Franchise:

- Cross Country Trains Limited (franchise agreement);
- Arriva Trains Wales Limited (franchise agreement);
- DB Regio Tyne and Wear Metro Limited (concession agreement); and
- Grand Central Railway Company Limited (open access operator).

Rail franchises

7.3 In Great Britain, most passenger train services are provided under regional franchises awarded by the DfT to TOCs following a competitive bidding process. The franchise agreement between the Secretary of State and the relevant operator enables the DfT to exercise a very significant level of (and, at times, almost total) control. Franchise agreements regulate almost every conceivable aspect of service quality, including routes, timetables, staffing levels, staff training, cleanliness, passenger information etc. They also include requirements to deliver specific improvement initiatives offered by the operator in its bid. A franchise is usually awarded for a period of seven to 15 years

7.4 Many fares offered by franchised TOCs are regulated through the franchise agreement such that the maximum price of such fares is controlled. Both the overall increase in the price of a fare, and the overall price of groups of fares in a basket are controlled, with permitted increases determined by the Secretary of State. The maximum increase permitted in the price of individual regulated fares is currently limited to RPI + 0%[6]. As such, franchise agreements can be likened to a form of complex management contract pursuant to which approval is required from the DfT for all but the most minor of decisions.

7.5 Franchise agreements often also include profit-sharing arrangements with Government. For the Northern Franchise, Arriva has a profit share arrangement, which can result in it paying between [✂] of incremental profits once certain thresholds are breached. Profit share arrangements of this kind also have the potential to dilute volume growth

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6 [✂]

incentives and, [✂]. Such profit-sharing arrangements will therefore be relevant to the consideration of an operator's incentives, in particular where, as in Arriva's case, it operates bus routes which overlap with the Northern Franchise.

Concession agreements

7.6 Concession agreements are typically more prescriptive even than franchise agreements, leaving the operator no discretion over price or any aspect of services, and giving it no incentive to increase passenger numbers. In its Phase 1 investigation, the CMA examined the DB Regio Tyne & Wear Metro agreement and noted the complete absence of flexibility to alter fares or non-price aspects and the fact that all fare revenues (and therefore revenue risk) were for the account of the owner and manager of the concession agreement. For these reasons it excluded from further analysis any overlaps between the Northern Franchise and the Tyne & Wear Metro[7]. Arriva assumes that a similar approach will be adopted in the Phase 2 investigation.

Open access

7.7 Open access operators have much greater freedom than franchise operators – particularly in relation to fares and aspects of service quality, such as how rolling stock is fitted out, staff training etc. However, the timetables of open access operators are heavily circumscribed because they are granted limited track access rights by the Office of Rail and Road ("**ORR**") and any extension of these rights would require ORR approval. They also operate alongside franchised operators, so their pricing decisions will be constrained by the regulated fares offered by competing operators under a franchise agreement, (particularly in light of the commercial risk borne by open access operators in respect of their services).

7.8 Therefore, while a differential approach will need to be taken in respect of overlaps between Northern Rail and one of Arriva's franchised rail services (e.g. to take account of relevant provisions of the rail franchise agreements) as compared to any overlaps between Northern Rail and Grand Central, significant limits also exist in respect of an open access operator's ability to vary fares or services.

Interaction between regulated and unregulated fares

7.9 As noted above, regulated fares place important constraints on unregulated fares, effectively operating as a cap on the price of unregulated tickets. They also create a perception amongst passengers about what constitutes a "fair" amount to pay for a fare where regulated and non-regulated tickets are both available for a particular journey. This interaction is demonstrated clearly in the internal documentation of open access operator Grand Central, which was provided to the CMA during Phase 1. The constraint exercised by regulated fares on unregulated fares has also previously been acknowledged by the Competition Commission and the OFT[8].

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[7] CMA Phase 1 Decision, para. 94.

[8] See *FirstGroup/Great Western* (2006), in which the CC noted that regulated fares constrain unregulated fares to some extent "*particularly where…the unregulated fares have increased and are now only slightly below the level of the unregulated fare and cannot therefore be increased much further without passengers choosing to pay the regulated fares instead*", para. 3.5; *National Express/Thameslink and Great Northern Franchise* (2005), which highlighted the particular sensitivity of leisure passengers to increases in price of unregulated fares, para. 9.27; and *Govia/South Central* (2009), which acknowledged the fact that "*regulated fares do provide at least some constraint on unregulated fares*", para. 72.

Importance of maintaining relationship with the DfT

7.10 Arriva's relationship with the DfT is of fundamental importance to Arriva, both in terms of current and future franchises. Arriva's operation of a franchise requires very close and extensive cooperation with the DfT and Arriva's fulfilment of its franchise commitments has a crucial bearing on future franchise awards, which are tendered on a rolling basis. This relationship is an important consideration for the CMA to take into account in its Phase 2 analysis, in particular when considering Arriva's incentives during the competitive assessment.

Transitory nature of rail franchises

7.11 The nature of the rail franchising model in Great Britain means that there is no certainty that a franchise operator will hold a particular franchise beyond the short (to medium) duration of the relevant franchise agreements. The transitory nature of these contracts therefore is very relevant to the CMA's assessment of Arriva's incentives when conducting its competitive assessment during Phase 2: Arriva would not put at risk its on-going and long-term bus operations as a result of a franchise which has only been awarded for the short-to-medium term.

8. BUS REGULATION

Increasing bus regulation

8.1 While bus markets in the UK outside of Greater London were previously deregulated, they have become increasingly regulated in recent years. Currently, local transport authorities have a number of mechanisms which they can use to regulate bus operator behaviour, including Voluntary Partnership Agreements ("**VPA**") and Quality Contract Schemes ("**QCS**"), which are discussed below in further detail. The Bus Services Bill, which is anticipated to receive Royal Assent by early 2017, provides for significantly enhanced regulatory powers for local authorities, including the prospect of franchising. Existing regulation and the prospect of further potential regulation act as a significant overall constraint on Arriva's commercial behaviour.

Impact of bus regulation

8.2 The following mechanisms are currently in place which limit the ability of bus operators to make independent pricing and service decisions:

- **Voluntary partnership agreements:** Local authorities have the power to enter into VPAs with bus operators under which one or more local authorities makes improvements to bus services to passengers, and one or more bus operators provides services of a particular standard. A VPA is in place in the Tees Valley region, and a similar but more extensive scheme covering the Liverpool City Region has been approved;

- **Quality Partnership Schemes:** Local authorities can enter into a QPS with bus operators. A QPS is a formal agreement under the Transport Act 2000 whereby one or more local authorities provides particular facilities, and operators of local services who wish to use the facilities must undertake to provide local services of a particular standard when using them. Arriva North West has QPS agreements in respect of number of Merseyside, Halton and Wirral services;

- **Quality Contract Schemes:** QCS enable local authorities to control the provision of bus services through a tendering process. Such schemes have been actively considered by several authorities; and

- **Multi-operator ticketing schemes:** Multi-operator ticketing schemes are a further way for local authorities to exert significant controls over bus operators. Local authorities have statutory powers to create, and require operators to participate in, multi-operator ticketing schemes, including network tickets. Such schemes have grown significantly since the Competition Commission's local bus market investigation in 2010-2011. Schemes currently in operation in the relevant area include the Nexus scheme (Tyne and Wear), Metro West Yorkshire's M-Card Day Rover and Metrocard, Transport for Greater Manchester's System One and Merseytravel's Solo, Trio and Saveaway schemes.

8.3 These existing mechanisms will be further strengthened by the following measures proposed under the Bus Services Bill:

- The introduction of new wide-ranging franchising powers for local authorities which will replace the QCS powers in England;
- The creation of Advanced Quality Partnership Schemes, designed to be more attractive and straightforward for local authorities to implement than the current QPS; and
- The creation of a new type of partnership – Enhanced Partnerships – giving local authorities broad discretion to regulate matters such as frequency and timetables and operational requirements (including payment methods and ticketing structure), based on majority support from bus operators.

Importance of maintaining relationships with local authorities

8.4 The current potential for direct intervention and change by local authorities (e.g. the introduction of a QCS) represents a considerable incentive for Arriva to run its bus services to an appropriate standard. The anticipated additional powers envisaged under the Bus Services Bill indicate further the importance of maintaining positive relationships with local transport authorities and the growing extent of regulation in the bus sector.

8.5 Indeed, local transport authorities are a key stakeholder in Arriva's bus business. Anecdotally, senior managers in Arriva's UK Bus operations, including in the Northern Franchise area, report that a significant proportion of their role entails managing relationships with relevant local authority partners. Local authorities are also a customer of Arriva (e.g. where subsidised or tendered bus services exist, or for fixed term arrangements for the provision of travel under the English National Concessionary Travel Scheme). Therefore the maintenance of good relationships is of paramount importance.

9. OPTIONS AVAILABLE TO PASSENGERS

9.1 Passengers have access to a wide range of options for travel. These include public transport options as well as private transport (e.g. taxis, private cars[9], bicycles and walking) and park and ride services. Public transport operators therefore are constrained by a wide variety of sources, and competition from all these other options drives service quality and innovation. Within the bus industry in particular, Arriva notes that passenger churn is high, meaning that bus operators, including Arriva, must attract significant numbers of new passengers every year to maintain existing sales against a background of long-term decline in passenger demand[10].

9.2 As regards public transport options, as noted above, the level of competition between modes of transport varies on a flow-by-flow basis, but Arriva generally agrees with the CMA's assumption that competition is often most intense between the same modes of

[9] In particular, Arriva notes that fuel prices have declined significantly and this may influence greater use of private cars.

[10] There has been a 1.6% decrease in local bus passenger journeys in the UK (excluding Greater London) over the past year. This decline has totalled 8% since 2009.

public transport: that is to say, rail typically competes more directly with rail, and bus competes more directly with bus[11].

Competition within the supply of bus services

9.3 In respect of bus services, Arriva faces competition from both large established bus operators present in the region (e.g. Stagecoach and First) and from smaller and mid-sized operators (such as Rotala, D&G Bus and Routemaster). Competition between these bus operators takes place across a number of core parameters, including quality of service and fares. Existing and prospective bus regulation (as discussed in Section 8 above) has given rise to increasing scrutiny and analysis of operators' conduct.

9.4 Market entry can and does occur frequently in relation to bus services, given the very low barriers to entry (see Section 12 below). Even in situations where competitors do not currently compete directly head-to-head on particular flows, other operators can quickly, through only minor adjustments to their services, create more direct competition on a particular flow, for example by adjusting routes or timetables for existing services, or introducing new services where an opportunity to do so arises. As a result, bus operators are effectively constrained through the ongoing threat of potential entry.

10. THE COMPETITIVE EFFECTS OF THE MERGER

10.1 Arriva sets out below the reasons why it has neither the ability nor incentive to increase fares or degrade service quality in respect of overlapping rail-on-rail or bus-on-rail services.

10.2 Arriva also notes that the award of the Northern Franchise will result in considerable benefits for passengers, including refurbishment of the existing rail fleet, the provision of new rolling stock for Northern Franchise services and free Wi-Fi on board all trains and at certain stations. These significant enhancements to the Northern Franchise were acknowledged by the DfT when it announced the award to Arriva[12].

10.3 The Northern Franchise was awarded to Arriva after a competitive bidding process which adjudged the Arriva tender to be the most economically advantageous, assessed against a broad range of criteria including innovation, supporting infrastructure change and customer experience. An ambitious programme of service improvements and innovations was proposed by Arriva as part of the bidding process, assessed by the Secretary of State during the tender evaluation process and now forms part of the Franchise Agreement. Absent the merger, such benefits for consumers could only have been achieved in a less economically advantageous way, if at all.

A. Rail-on-Rail

10.4 Arriva has neither the ability nor the incentive to raise prices or degrade services on overlapping rail-on-rail flows for the numerous reasons set out below. More generally, Arriva also notes that, in light of the franchising model and the extent of existing price regulation, competition for the market is generally more relevant than competition in the market.

1. <u>Competition "for the market"</u>

10.5 At Phase 1 the CMA concluded that there was no realistic prospect of an SLC when assessing competition 'for' the market (i.e. in respect of competition for the award of rail franchises) because:

10.5.1 The award of the Northern Franchise to Arriva would not reduce the numbers of

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11 CMA Phase 1 Decision, para. 34.

12 https://www.gov.uk/government/news/massive-boost-to-rail-services-brings-northern-powerhouse-to-life

bidders for future franchises;

10.5.2 It would not confer any incumbency advantages on Arriva for future franchise awards;

10.5.3 Arriva's combined share of franchises and the increment obtained through the Northern Franchise are not significant (estimated at no more than 25% and less than 10% respectively on any metric); and

10.5.4 No third parties raised concerns about the impact of the award of the Northern Franchise on competition for the market.

10.6 Arriva sees no reason to depart from this view in the Phase 2 investigation.

2. Competition "in the market"

No ability to increase prices or degrade services on overlapping flows

10.7 The terms of the Franchise Agreement significantly restrict Arriva's commercial freedom:

- **ARN is subject to fares regulation**, which will regulate the maximum price of many of the fares it offers. While ARN can amend the price of some off-peak services, this only applies in respect of dedicated fares (i.e. fares only available for use on ARN's services) or, where fares are inter-available, cases in which ARN is the lead operator on the route. By way of illustration, more than 90% of fare revenue on overlaps with the Northern Franchise is derived from inter-available tickets[13], more than one third on flows where ARN is not the lead operator and therefore not in control of setting fares. On average, the proportion of regulated fares on the Northern Franchise overlaps is over two-thirds (over half by revenue). That means that, for a significant proportion of fares (by revenue), ARN is either unable or constrained in its ability to increase price;

- **ARN has extremely limited ability to alter its offer on Northern Franchise services.** This is the case primarily because it is subject to detailed commitments in its Franchise Agreement, specifying which services are to be operated (together with a very broad range of additional binding obligations) and which therefore limit its ability to alter services on the Northern Franchise. For instance, the Franchise Agreement includes obligations with respect to journey time, timetable and multiple other aspects of service quality. ARN faces a strong set of contractual and reputational incentives ensuring compliance with the Franchise Agreement (also discussed below).

10.8 It is important to note that the Franchise Agreement prescribes demanding performance benchmarks, which were set after a competitive bidding process in which bidders detailed investment projects and service improvements they could offer. As such, meeting such performance benchmarks does not constitute "degradation" of service in respect of the Northern Franchise[14] - the benchmarks represent the highest possible standards as defined through a competitive bidding process.

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13 All franchised TOCs are obliged to offer "inter-available" fares (i.e. fares that can be used on the services of any train company) under an industry-wide scheme. There are also detailed procedures for the setting of fares and distribution of revenue in respect of these fares. The lead operator (typically the operator with the greatest commercial interest on a certain route) sets the inter-available fares which must be observed by all TOCs selling tickets for that journey or operating a service on some or all of that route.

14 Arriva notes that the Phase 1 decision appears to have adopted a very cautious approach on this issue.

10.9 Arriva's other franchised rail operations, ATW and Cross Country[15], are subject to similar significant contractual restrictions[16]. Grand Central, as an open access operator, has additional flexibility, but its ability to make timetable changes is restricted by the scope of its track and station access rights. A differentiated approach between these types of rail operators is therefore merited.

10.10 Furthermore, the fact that each Arriva TOC is operated as a separate corporate entity within the UK Rail division, with its own senior management and commercial team dedicated to the management of each Arriva rail service, represents a barrier to any coordinated approach between Arriva rail franchises, [✂].

No incentive to increase prices or degrade services on overlapping flows

10.11 As Arriva does not have the ability to reduce services on its rail franchise routes, it is not necessary to consider whether it would have the incentive to do so. In any event, Arriva's relationship with the DfT would be a key factor.

10.12 Although Arriva has the ability to alter a limited sub-set of off-peak fares, any incentive to do so is reduced by the fact that this would lead to some customers switching to using competitor rail services or other modes of transport, including private vehicles. It would also have the consequence of diverting some off-peak customers onto already overcrowded peak time services (where the price is regulated). In addition, even where Arriva is not constrained in its ability to increase price, it may choose not to do so due to the effect on its other services/the rest of the network and the need to maintain a coherent fare structure.

10.13 Furthermore, given the significant presence of third party competitors on a number of flows, it may be unprofitable for Arriva to raise prices, as passengers may divert to a third party competitor rather than an alternative Arriva service. The incentive for Arriva to raise prices on its rail services will be further considered as part of the Phase 2 process through profit-incentive analysis and survey analysis, which will help determine whether it would be profitable for Arriva to pursue such a strategy, given the reasons set out above.

10.14 While Grand Central has greater commercial freedom than franchised operators to set fares, Grand Central must ensure that its fares are priced by reference to its competitors and, in this respect, regulated fares represent a considerable constraint on its pricing policies. Grand Central also considers it necessary to ensure that its dedicated walk-up fares are priced competitively against inter-available products.

10.15 Grand Central will also have no incentive to degrade service/increase fares on overlap flows with the Northern Franchise. The overlap flows between the Northern Franchise and Grand Central contribute a very small proportion of revenue (less than [✂]) on Grand Central's two services (London-Sunderland and London-Bradford). The potential impact of any service degradation/fare increase on other services or the rest of the network means that Grand Central would not pursue this course of action. In any event, the overlap between Grand Central and the Northern Franchise is quite limited. Grand Central services are very infrequent (e.g. typically four-five services a day).

10.16 Finally, as noted above, the Franchise Agreement provides for a risk/profit sharing mechanism between ARN and the Secretary of State, pursuant to which ARN would retain only some parts of the profits it registers in any given Franchise year above particular thresholds. The effect of this mechanism is that any additional profit derived beyond a defined threshold is shared between Arriva and the Secretary of State [✂]. This revenue sharing-mechanism is particularly relevant to ARN's incentives for entering into the

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15 Franchises which overlap with the Northern Franchise.

16 Detailed submissions on the various franchise agreements were made during Phase 1. Arriva will be happy to supply further copies of these if helpful.

transaction and any potential incentives to shift passengers between its rail services or divert passengers from bus to rail to increase profits.

B. Bus-on-rail

10.17 Arriva sets out below the multitude of reasons why it has no ability or incentive to either raise prices or degrade services on its bus services. More generally, Arriva notes that competition between bus and rail services plays a relatively insignificant role in Arriva's management decisions.

No ability to increase prices or degrade services on overlapping flows

10.18 It is almost impossible for Arriva to reconfigure services in respect of an individual flow in isolation. This is because reconfiguring services on an individual flow will likely result in consequential changes to the rest of the route, including changes to frequencies and timetables, which will have been optimised for passengers which represent the majority of the revenue on the relevant route. Furthermore, while generally speaking Arriva has flexibility over its bus timetables, timetable changes must be notified with a 56 day public notice period.

10.19 It is also very difficult for Arriva to increase fares on a flow-by-flow basis. With the exception of the Merseyside area (which applies a flat fare structure) Arriva applies a graduated fare structure across its bus operations in the Northern Franchise area. This fare structure means that the ability to increase the fare on a particular sub-segment of a route, without broader consequential changes to the fare structure, is constrained by the next price point in the graduated structure.

10.20 In Merseyside, the flat fare structure constitutes a significant barrier to price increases by Arriva on particular flows. Any changes to the flat fare structure can only be made by either breaking up that system, or by 'flexing' the fare applicable across a significant geographic area and across a large number of services.

10.21 Further constraints on Arriva's ability to amend pricing in respect of individual flows include multi-operator ticketing schemes (the prevalence of which has increased significantly since the Competition Commission's local bus market investigation in 2010-2011) and concessionary fares.

10.22 In any event, the separation of Arriva's UK Bus and UK Rail divisions indicates that it sees no potential advantage to coordinating strategy between the bus and rail divisions.

No incentive to increase prices or degrade services on overlapping flows

10.23 Arriva has been active in the bus sector for approximately 30 years and this business represents a very important and stable business for Arriva. Arriva's upgrade of its core fleet in 2014 (with a cost in excess of £40 million) indicates Arriva's on-going commitment to its bus business. Conversely, its Northern Franchise rail operations are inherently transitory in nature due to the defined franchise period under the Franchise Agreement. The contrasting temporal nature of these businesses operates as a considerable commercial disincentive on Arriva to make modifications to its bus services with a view to (potentially) recouping associated losses via Northern Franchise rail services.

10.24 Moreover, any attempts by Arriva to increase profits by transferring passengers from its bus services to the Northern Franchise would face a number of obstacles and uncertainties:

- First, passengers that are diverted away from Arriva’s bus services can in many cases switch to competitor bus services (intra-modal competition is in general expected to be stronger than inter-modal competition) or private transport. Indeed, the competitive nature of the bus market means that any service gaps could be filled quickly by rival bus operators. In light of the current low barriers to entry in the bus market (including the 56 day notice period mentioned above), entry could come from any one of a number of large national groups or smaller local operators. Any passengers that are successfully switched from bus to rail may switch to a Northern Franchise or to a competitor rail service if one is available. These effects would limit any revenue increase that Arriva could experience in rail as a result of the strategy.

- Second, each bus flow is part of a route, which itself is part of a wider bus network. A reduced service or higher price on one flow is likely to have consequences for other flows on the route. Higher prices and/or lower frequencies on one flow would often require adjustments to frequencies and fares across the whole route to ensure a coherent pricing structure and timetable. Such changes may be suboptimal for the other flows on the route and may therefore reduce profits. Beyond the individual route, there may be impacts on the wider Arriva bus network. For example, if a reduced service on one flow prevents a passenger from connecting with the wider Arriva network, revenues may be foregone.

- Finally, on the supply side, any cost savings from reducing bus frequency/increasing fares are uncertain and case specific. Any savings would depend on the extent to which driver, vehicle or other costs would be reduced in such a scenario. For example, bus companies optimise their networks by interworking buses between different routes during the day. Changes to frequency on one route may have impacts on the efficiency of this interworking, leading to suboptimal outcomes and lower profits across the network.

10.25 In addition, Arriva faces an ongoing threat of potential entry. The low barriers to entry in the bus industry are such that any increase in price or degradation of service risks the introduction of new services or the expansion of existing services. This threat is itself an effective constraint on Arriva.

10.26 In order to determine whether for some flows, despite these obstacles, Arriva does have an incentive to divert passengers from its bus services to the Northern Franchise, we intend to carry out a profit incentive analysis to determine whether such a strategy is expected to be profitable, taking into account all of the factors described above. Such an analysis requires information on diversion ratios between Arriva's bus services and the Northern Franchise, which may need to be obtained through passenger surveys.

10.27 The increasing regulation of the bus sector in recent years operates as a further disincentive to any price increases or service changes by Arriva. As set out at Section 8 above, local transport authorities currently have a range of tools which can be used, as necessary, to exert control over bus services, with the forthcoming Bus Services Bill demonstrating the sustained intention at both local and national level to regulate further the bus industry. In addition to the specific powers available to local authorities to restrict fares and service quality (outlined above), Arriva UK Bus continually seeks to work with local authority partners to attempt to satisfy their demands. This generally results in a great degree of compromise on the operators' part including in respect of network stability, fare increases and investment.

11. FLOW BY FLOW ANALYSIS

11.1 Arriva considers that any individual flow analysis should take account of the full set of competitive, regulatory and socio-economic dynamics applicable to each flow and the services operating on it.

11.2 Factors and features which are likely to be relevant to the flow-by-flow assessment and will need to be taken into account as part of this analysis are wide-ranging and may include, among others:

Factors that indicate that the overlapping services do not compete or only compete to a limited extent, such as:

- Passenger preferences, e.g. for a particular mode of transport, including the car;
- Geographical factors that indicate bus and rail services within the defined catchment area do not compete or are weak substitutes; and
- Other evidence that there is no or only limited competition between bus and rail services on a flow, e.g. generalised costs arguments, significant asymmetry of revenues, passengers and journeys.

Factors that restrict Arriva's freedom to increase prices or make changes to service, both individually and in combination, such as:

- Regulation of rail fares and service levels including, where relevant, as a result of the highly prescriptive nature of Arriva's rail franchise agreements;
- The relationship between regulated and unregulated rail fares on the flow;
- Proportion of inter-available fares on rail flows, and extent to which Arriva (as the lead operator) has the ability to set these fares; and
- Restrictions on changes to bus services arising from tender contracts or other local authority schemes, together with 'soft' pressure exerted by local authorities to justify any proposed changes to services or fares.

Factors that reduce or eliminate any incentives to raise prices or degrade service on overlapping flows, such as:

- In relation to rail/rail overlaps, the duration of any overlapping franchise services on the flow;
- Evidence that changes in price or service on overlapping flows would not be profitable, e.g. the impact of the profit sharing mechanism in the Franchise Agreement, ORCATS allocation, the proportion of inter-available fares and the proportion of regulated fares on the flow, the respective rail and bus margins, the impact of concessionary fares, the impact of existing fare structures;
- A proper account of the potential for third party entry and/or expansion. Arriva notes that the approach applied at Phase 1 for assessing potential competition was not appropriate for the reasons set out in Section 12 below;
- Data indicating there is only limited incentive to make changes, e.g. where there is only a minimal increment in frequency on the flow as a result of the Transaction;

and

- Data suggesting that the flow is of insufficient value for Arriva to make standalone changes, e.g. low revenue or passenger numbers.

11.3 Arriva anticipates that, viewed against these factors and others which may be relevant in the particular circumstances, it will be clear that substantive and material concerns do not arise in relation to its acquisition of the Northern Franchise.

12. BARRIERS TO MARKET ENTRY/EXIT

Appropriate framework for assessment of potential competition

12.1 It is imperative that the CMA takes full account of the scope for potential competition to constrain Arriva's activities in respect of the overlap flows. Arriva strongly considers that:

12.1.1 The possibility of market entry or expansion by itself (i.e. even absent that entry actually occurring) plays as a constraint on Arriva's conduct and as an incentive to maintain fares and services at a competitive level. In particular, in relation to bus services, the low barriers to entry on any route and visibility of demand/supply (see paragraphs 12.2 to 12.4 below) mean that Arriva, if not exposed to actual competition, is always exposed to the threat of competition on a route-by-route basis. Arriva considers that this threat is itself an effective constraint on it and that this threat exists alongside constraints from other modes of transport;

12.1.2 In relation to the bus industry, it is part and parcel of the ordinary course of business for bus operators to make changes to their operations where they see opportunities. Given the low barriers to entry and expansion, changes need not necessarily be "planned" far in advance. Rather, changes can be implemented relatively quickly in line with evolving market dynamics and in response to opportunities that arise, e.g. increased passenger demand or a weakening in competitors' services;

12.1.3 To fully capture these competitive dynamics, the CMA will need to consider potential competition on a broad basis. A focus only on instances where competitors have existing plans to enter or expand will underestimate the real scope of potential competition; and

12.1.4 It is not necessary that potential competition resolves all competition concerns on a route or flow outright for it to be taken into account in the CMA's analysis. The existence of a potential competitor in combination with other factors may in the round provide the CMA with evidence and comfort that competition concerns will not arise on the flow.

Barriers to entry/expansion in the bus industry

12.2 The bus industry is characterised by extremely low barriers to entry and expansion. Arriva would note that existing bus operators can enter a new route or expand services with only minimal investment. The only requirements for entry are[17]:

12.2.1 Access to vehicles: an operator can readily purchase or lease buses of an acceptable quality (including mid-life);

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[17] Access to patents or know-how does not in general give rise to barriers to entry or expansion in light of the nature of the bus industry.

12.2.2 Access to an appropriate depot or other form of operating base: in Arriva's experience, access to suitable depot facilities has not generally been a concern for it in the areas also served by the Northern Franchise. Smaller scale depots are particularly unlikely to raise issues. Although larger scale depots may involve more planning issues, these are unlikely to act as a significant barrier. There are in any event a range of other options available, assisted by the general decline of passenger demand, which would be particularly suitable for smaller operators, such as sharing depots, or using outstations for parking with maintenance conducted at further afield depots or subcontracted; and

12.2.3 Obtaining relevant licences: a summary of the relevant licensing regime is set out at paragraphs 12.5 to 12.6 below.

12.3 The regulatory barriers are minimal. Outside of London, changes to services (e.g. timetable changes, frequencies or route amendments or introductions) can be made on only 56 days' notice, providing operators with a considerable degree of freedom and flexibility to enter new areas and expand services.

12.4 There are a number of mature third party bus operators with depots or other operating bases within the area of the overlapping flows (including Stagecoach, First, Go-Ahead and other small and mid-sized operators such as Rotala and Routemaster). It would be relatively straightforward for any of these operators to enter onto or expand its services on a bus route or flow currently operated by Arriva.

Licensing

12.5 A bus operator must obtain a public service vehicle licence before commencing operations. A licence takes around nine weeks to be granted. A licence is required for each traffic area in which the operator has an operating centre (e.g. depot facilities) which permits (but does not require) a certain number of public service vehicles to be operated by the licence holder. In Arriva's experience, bus operators often maintain a large number of licences, giving them flexibility to deploy services in new areas as required.

12.6 Arriva does not consider that the licensing regime makes entry more difficult or costly. There is a marked level of small scale entry and expansion in local areas which indicates that the licensing regime does not give rise to material barriers to entry or expansion.

Economies of scale and scope

12.7 Entry or the possibility of entry by a competing bus operator does not have to be on a significant scale in order to provide a significant competitive constraint – given the point-to-point nature of journeys, entry on the more profitable or popular routes in any area or even just on part of a route, or only at times of high demand, is sufficient for that operator to be regarded as an actual competitor.

12.8 In any event, to the extent that there may be such economies of scale and scope, these are not significant barriers to entry. Indeed, smaller operators may have lower operating costs, such as lower wages, lower fleet and training costs and fewer pension commitments, giving them the ability to enter and exit routes relatively easily.

12.9 The growth of multi-operator ticket schemes also makes it even easier for small-scale operators with more limited services to enter or expand on a smaller-scale and still compete sustainably with larger incumbent operators. Within the area of the Northern Franchise, multi-operator bus schemes already exist across Merseyside, Greater Manchester, West Yorkshire, and Tyne and Wear.

Incumbency advantages

12.10 Arriva considers that there are very low incumbency advantages in the bus industry and that they are immaterial as barriers to entry:

- **Local knowledge:** the bus industry is relatively transparent and local knowledge is easy to pick up. Existing operators seeking to expand will in any event already have local market knowledge;

- **Brand loyalty/reputation:** brand loyalty amongst bus users is low, with most passengers catching the first bus which arrives at the bus stop and travels to their chosen destination; and

- **Costs:** operators can enter or expand routes with a low level of investment and sunk costs, in particular profitable routes with pre-existing services and high customer demand.

<u>Threat of retaliation</u>

12.11 There are a number of third party operators competing on bus routes operated by Arriva within the area overlapping with the Northern Rail franchise which do not appear to have been deterred by the prospect of any form of retaliation. Nor is the potential threat of an aggressive response by another competitor a factor that Arriva would take into account in deciding whether or not to operate services on any particular route. If such a barrier to entry existed in any material way, Arriva would not expect to see head-to-head competition by new entrants on any routes on which incumbent operators provide services.

<u>Barriers to exit</u>

12.12 Barriers to exit in the bus industry are minimal. Frequencies and routes can be withdrawn or scaled back on 56 days' notice. Services can also be established with limited investment and sunk costs, further reducing barriers to exit.

Potential sizeable entry in the bus and rail sectors in the next three years

12.13 Arriva is not currently aware of any expected sizeable market entries or exits in the bus sector in the Northern Franchise area within the next three years. However, as described above, in Arriva's experience, entry on a particular route or flow generally occurs on an opportunistic basis, and changes need not necessarily be "planned" far in advance. Arriva also notes that, within the next 2 to 4 years, the Greater Manchester area, (and potentially other areas) may be subject to franchising powers under the Bus Services Bill, which could result in significant changes to current operators, displacing some operators and attracting new entrants.

12.14 Within the rail sector, in 2017 the Barton-on-Humber to Cleethorpes service which currently forms part of the Northern Franchise is expected to be remapped to the East Midlands Franchise, such that it will no longer be part of the Northern Franchise.

13. THRESHOLD FOR ANALYSIS

13.1 As the CMA will be aware, its Phase 2 analysis proceeds under a different legal test from the deliberately cautious “double may” test applicable at Phase 1. Specifically:

13.1.1 The CMA must consider whether the Transaction “*may be expected*” to result in an SLC on any market or markets in the UK;

13.1.2 It considers the above question on a balance of probabilities standard;

13.1.3 In the event it identifies an SLC, any proposed remedies must be subject to a proportionality assessment; and

13.1.4 Separately and additionally, as this case was referred back by the European Commission to the CMA, the CMA "*may take only the measures strictly* *necessary to safeguard or restore effective competition on the market concerned*"[18].

13.2 The different legal tests are important when considering the analysis carried out and conclusions reached at Phase 1. While it is sensible and efficient to make use of analysis carried out in Phase 1 to avoid duplication, it will be important to re-examine Phase 1 material carefully, and to consider the additional evidence put forward, through the different lens applicable at Phase 2.

14. THE COUNTERFACTUAL

Alternative bidders

14.1 Arriva welcomes the CMA's acknowledgement in the Opening Letter that the *status quo ante* cannot be the appropriate counterfactual and that, as the Northern Franchise was coming to an end, it was necessary to award the franchise to one of the short-listed bidders, in this case Arriva, Govia or Abellio[19].

14.2 Arriva notes that the other short-listed bidders, Govia and Abellio, also operate services which overlap with those of the Northern Franchise. Accordingly there is no alternative bidder for the Northern Franchise which would not raise some potential competition concerns. In such a case, the CMA’s Guidance indicates that the appropriate counterfactual is the award of the franchise to: “*a hypothetical bidder, with any competition concerns being remedied through behavioural remedies*” [20].

14.3 It is inherent in this formulation that the counterfactual is not a situation of perfect competition:

14.3.1 The CMA Guidance sets out two alternative counterfactuals, the second of which (quoted above) should be used where the first is not available on the facts. If the two were identical in their effect, the second alternative would be redundant. It is clear that where there is no "clean" bidder, the counterfactual should be based on a bidder creating one or more SLCs; and

14.3.2 The Guidance specifies that those SLCs are remedied through behavioural and not structural remedies. Such remedies will be implemented following a proportionality assessment at Phase 2, and therefore would not necessarily entirely restore competition to the pre-award state.

Forward-looking analysis: franchise expiries

14.4 Arriva considers that it is important that the CMA takes proper account of anticipated developments in its assessment of the impact of the Transaction, and in particular the transitory nature of franchise agreements.

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18 This transaction constituted a concentration with an EU dimension within the meaning of Article 3(1)(b) and Article 1(2) of the EUMR. On 27 January 2016, the European Commission acceded to the Parties' Reasoned Submission (pursuant to Article 4(4) of the EU Merger Regulation) that the transaction be examined by the competent authorities in the United Kingdom (Case M.7897 – Arriva Rail North/Northern Franchise, Decision of 27 January 2016). However, as the CMA is aware, the referral of this case by the European Commission to the CMA imposes certain obligations on the CMA, in addition to its usual statutory obligations under UK competition law. In particular, under Article 9(8) of the EUMR, the CMA "*may take only the measures strictly necessary to safeguard or restore effective competition on the market concerned*".

19 Arriva notes that this approach is also consistent with previous practice, for example *Stagecoach/East Midlands passenger rail franchise* (2008).

20 Merger Assessment Guidelines para 4.3.29. Arriva notes that the Phase I decision appears to have misstated the appropriate counterfactual.

14.5 In respect of Arriva's current franchise agreements, Arriva notes that the following agreements which overlap with the Northern Franchise are due to expire in the short term and that it is not assured that Arriva will hold these franchises after the expiry date.

14.5.1 The **Cross Country Trains** franchise agreement is due to expire in October 2016. [✂]. Any direct award would be for a short period of time – to November 2019.

14.5.2 The **Arriva Trains Wales** franchise agreement is due to expire in October 2018. Significant uncertainty exists as to the terms on which any future competition for the award of the Wales & Border franchise will be tendered.

14.5.3 The **DB Regio Tyne and Wear Metro Limited** concession agreement is due to expire in March 2017. This was excluded by the CMA from its Phase 1 analysis (for reasons other than imminent expiry) and we assume that the CMA will adopt a similar approach during Phase 2[21]. However, for completeness, Arriva notes that while Nexus may, at its sole discretion, extend the term of the concession to March 2019, Arriva's understanding is that Nexus does not intend to exercise its right to extend.

14.6 These periods are a key part of the substantive analysis at flow by flow level. The CMA will analyse the impact of the Transaction on individual flows, and consider whether there is any resulting lessening of competition. If so, it will need to consider the magnitude of that loss. Effects that will be felt only in the short to medium term are much less likely to meet the “substantial” standard.

15. CONCLUSION

15.1 For all of the reasons set out above, Arriva is confident that the Phase 2 process will enable the CMA to conclude that the transaction will not result in an SLC on any relevant market.

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21 As noted above, in Phase 1 all Northern Franchise flows that overlap with the Tyne and Wear Metro were excluded due to the fact that the management contract in place for Metro services removes all flexibility to alter fares or non-price aspects and all fare revenues are for the account of Nexus. As such, the CMA concluded that there is no incentive to increase passenger numbers or degrade the overlapping Northern Franchise service.

ANNEX 1

ARRIVA ORGANISATIONAL CHART

[✂]

ANNEX 2

EVENTS LEADING TO THE AWARD OF THE NORTHERN FRANCHISE

The events leading up to the award of the Northern Franchise to ARN are follows:

Date	Event
5 June 2014	Joint notice relating to the TransPennine Express and Northern Franchise submitted for publication in the Official Journal of the European Union.
6 June 2014	DfT published Northern Franchise pre-qualification questionnaire, pre-qualification process document and franchise letting process agreement.
9 June 2014	DfT published the Northern Franchise prospectus for potential bidders.
9 June 2014 to 18 August 2014	DfT consulted in parallel on the awards of the Northern and TransPennine rail franchises in a consultation titled *Transforming the North's Railways*.
27 February 2015	DfT published a stakeholder briefing document and consultation response on the Northern and TransPennine rail franchises; DfT published the Invitation to Tender ("**ITT**") for the Northern Franchise.
26 June 2015	Arriva submitted its bid for the Northern Franchise.
[✂]	[✂]
[✂]	[✂]
9 December 2015	Formal announcement by DfT of award of Northern Franchise to Arriva.
12 December 2015	Arriva signed the Franchise Agreement
22 December 2015	Secretary of State for Transport signed the Franchise Agreement following a voluntary standstill period of 10 days.

Details of negotiations with the DfT

- The process which led up to the award of the Northern Franchise is set out in detail in the ITT published by DfT[22]. Section 4.13 of the ITT describes the process which took place following the bid submission, namely: (i) bid evaluation, (ii) engagement with Bidders and evaluation clarification, (iii) contractualisation, (iv) the intention to award, (v) the signature of the Franchise Signature Documents, (vi) the announcement to the LSE and information to unsuccessful bidders, and (vii) the voluntary standstill period. Section 4.2 of the ITT also describes at a high-level the steps which took place following the submission of Arriva's bid up to the start of the franchise on 1 April 2016.

- The terms on which DfT wished to award the Northern Franchise were set out in the ITT. Any deviation from those terms in Arriva's bid could have resulted in its bid being deemed non-compliant, and subsequently excluded from the bidding process. [✂].

- [✂]. Section 7.7 of the ITT provides a summary of the process which the DfT followed in relation to the drafting of the Committed Obligations.

- [✂].

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22 Available at:https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407802/northern-invitation-to-tender.pdf

ANNEX 3

OVERVIEW OF ARRIVA, ARN AND ARRIVA BUSINESSES OVERLAPPING WITH THE NORTHERN FRANCHISE

Deutsche Bahn AG ("Deutsche Bahn")

1. Deutsche Bahn is based in Berlin and was founded in 1994. Deutsche Bahn is one of the world's leading mobility and logistics companies, and operates in more than 130 countries. Deutsche Bahn operates passenger transport in Germany, rail freight services across Europe and logistics services globally. Deutsche Bahn's UK rail freight services are operated by DB Schenker Rail (UK) Limited. Deutsche Bahn is 100% owned by the Federal Republic of Germany. Deutsche Bahn acquired control over Arriva on 27 August 2010[23].

Arriva plc ("Arriva")

2. Arriva is a wholly-owned subsidiary of Deutsche Bahn.

3. Arriva originated in Sunderland in 1938 and first began providing bus services in 1980. Arriva first began providing passenger rail services in 2000.

4. Arriva is a significant operator of passenger transport services both in the UK and in Europe. In the UK, Arriva provides passenger rail services (both heavy rail and light rail), bus services, non-emergency patient transport services and specialist education transport services.

5. Arriva is divided into three divisions: UK Bus, UK Trains and Mainland Europe, each with its own management teams and divisional directors. Furthermore, the Arriva business is operated on a devolved basis. This means that each train and bus operating company has separate management and commercial objectives to achieve. Arriva attaches at **Annex 1** organisational charts relating to bus and rail, as at 1 March 2016. Arriva's businesses also operate in a regulated environment which circumscribes considerably their day-to-day actions. For further detail on the regulatory environment, please see Section 7 above.

Arrival Rail North Limited ("ARN")

6. ARN is a wholly owned subsidiary of Arriva UK Trains Limited, which itself is an (indirect) wholly owned subsidiary of Arriva and, ultimately, Deutsche Bahn.

7. ARN was dormant prior to becoming the franchisee of the Northern Franchise.

8. Apart from the wholly-owned subsidiaries described above, neither Deutsche Bahn nor any member of its group has any interest in or influence over any firms operating services overlapping with those of the Northern Franchise. Nor have any such firms an interest in or influence over any part of the Deutsche Bahn group. Prior to the award of the Northern Franchise, there was no previous relationship between ARN and the Northern Franchise.

Arriva Rail Business – history and overview

9. Arriva first offered passenger rail services in 2000. In 2003, Arriva won the tender for a 15-year integrated passenger rail franchise, creating Arriva Trains Wales. In 2007, Arriva was awarded the Cross Country rail franchise. In 2009, Arriva backed the previous founder and managing director of Grand Central, Ian Yeowart, to launch Alliance Rail Holdings ("**Alliance Rail**") an open access rail company[24]. In 2011, businesses outside of Germany which were previously operated by Deutsche Bahn became part of Arriva. Within the Arriva rail business, such businesses included: Chiltern Railways, London Overground Rail Operations, and Tyne and Wear Metro. In 2011, Arriva acquired the open access rail operator Grand Central Railway.

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[23] Case No COMP/M.5855 DB/Arriva, Decision of 11 August 2010.

[24] See for details: http://www.railpro.co.uk/railpro-magazine/magazine-archives/rail-professional-interview-ian-yeowart

10. Arriva's acquisition of the Northern Rail Franchise and the award of the London Overground concession in March 2016 represent the main examples of significant market entry by Arriva into the rail market within the past 5 years. With the exception of the London Overground concession in March 2016, no franchises or concessions have come to an end in the past 5 years.

11. In addition, outside of the Northern Franchise area, Arriva notes that in May 2015 certain routes which were previously managed under the Greater Anglia Franchise were remapped into the London Overground concession and, in October 2015, Chiltern Railways commenced operations to Oxford Parkway.

Arriva rail businesses which currently overlap with the Northern Franchise:

12. Arriva currently holds the following franchises and concessions for passenger rail services in the UK in the Northern Franchise area:

- **CrossCountry Trains Limited ("XC")** – XC rail services are provided under a franchise agreement with the Secretary of State. Services span the UK from Aberdeen, Dundee and Glasgow in the North to Stansted Airport, Bournemouth, Plymouth and Penzance in the South. Some of XC's services overlap with those of the Northern Franchise.

- **Arriva Trains Wales ("ATW")** – ATW services are provided under a franchise agreement with the Secretary of State. The services are provided predominantly within Wales but there is some overlap with the Northern Franchise around the Manchester area.

- **DB Regio Tyne and Wear Metro Limited ("DBTW")** – Arriva operates DBTW under a Concession Agreement with Nexus, the Passenger Transport Executive for the Tyne and Wear region. The Tyne and Wear Metro services overlap with a number of the services provided by the Northern Franchise, but Nexus retains the right to set timetables, service levels and fares and carries the revenue risk.

13. Arriva also owns the following UK open access operator in the Northern Franchise area:

- **Grand Central Railway Company Limited ("Grand Central")** – Grand Central is an open access operator which provides direct high speed train services between London King's Cross and Sunderland. In addition, there are services between King's Cross and Bradford. There is some overlap between Grand Central and the Northern Franchise. Grand Central's track access agreement with Network Rail will expire in November 2026.

Arriva rail businesses which do not currently overlap with the Northern franchise:

14. Arriva currently holds the following franchises and concessions for passenger rail services and open access operators in the UK which do not overlap with the Northern Franchise:

- **London Overground Rail Operations Limited ("LOROL")** – LOROL is a joint venture between Arriva and MTR Corporation (of Hong Kong) which operates the LOROL Concession on behalf of Transport for London. The current Concession Agreement is due to expire in November 2016. In March 2016, the London Overground Concession was awarded to Arriva (bidding alone i.e. no longer in a joint venture with MTR Corporation). There is no overlap with the Northern Franchise.

- **The Chiltern Railway Company Limited ("Chiltern")** – Chiltern is operated by Arriva under a franchise agreement with the Secretary of State which is due to expire in December 2021. Services are operated between Birmingham Snow Hill and London and there is no overlap with the Northern Franchise.

- **Alliance Rail Holdings** – Alliance Rail was founded in 2009 and is majority-owned by Arriva UK Trains Limited, operating through its subsidiary companies Great North Western Railway Company Limited ("**GNWR**") and Great North Eastern Railway Company Limited ("**GNER**"). Neither GNWR nor GNER currently provide rail services. Therefore, there is currently no overlap with the Northern Franchise.

In August 2015, GNWR secured a track access agreement from the ORR to run services between London and Blackpool. In May 2016, the ORR refused an application by GNER to operate services between London King's Cross and Edinburgh and London King's Cross and West Yorkshire/Lincolnshire.

15. Each of these businesses has its own dedicated senior management and commercial teams which are dedicated to the management of each Arriva rail service. They are therefore responsible for compliance with the franchise agreement (where the rail services is operated under a franchise agreement) and the operational aspects of the service, such as timetabling and revenue management.

Arriva Bus Business – history and overview

16. Arriva first entered the UK bus market in 1980 through its acquisition of Grey-Green and acquired the British Bus Group (the former national transport provider) in 1996. In 2006, Arriva acquired Premier Buses Limited, a transaction which was approved by the Office of Fair Trading[25]. The Arriva UK Bus division provides local bus services across the geographic area served by the Northern Franchise, including across Liverpool, West Yorkshire, Northumberland and Teesside.

17. Significant events in the Arriva UK bus business in the past 5 years include the following:

- In March 2012, Arriva invested £26.7m in 98 low carbon emission buses for its fleet, comprising 77 hybrid electric double deck vehicles and 21 carbon-neutral bio gas-fuelled single decks.
- Arriva sold its Renfrewshire and East Renfrewshire bus operations to McGill's Bus Services Limited, which was approved by the Competition Commission on 21 September 2012[26].
- Arriva sold its investment in the Original London Sightseeing Tour Limited in 2014.
- In early 2014 the directors of Tellings-Golden Miller ("**TGM**"), a subsidiary of Arriva, approved a restructuring programme for TGM with the aim of exiting much of the TGM business through closure or sale. This was completed in late 2014 with two profitable contracts (Transport for London & East Midlands Airport) retained in TGM.
- Arriva's acquisition of the operations and assets of Liyell Limited, which was approved by the OFT on 21 January 2014[27].
- In April 2014, Arriva UK Bus announced an investment programme worth in excess of £40 million to facilitate a major upgrade of its core fleet, including a partnership with two of the UK's leading bus manufacturers to implement the strategic introduction of more than 200 new carbon efficient vehicles over the subsequent 12 months[28].

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25 ME/2341/06, *Completed acquisition by Arriva plc of Premier Buses Limited,* Decision of 1 June 2006.

26 *McGill's Bus Services Limited/Arriva Scotland West Limited merger inquiry*, Decision of 21 September 2012.

27 ME/5677/12 *Completed acquisition by Arriva Midlands North Limited of the business and assets of Liyell Limited trading as Midland*, Decision of 21 January 2013.

28 See Arriva press release dated 10 April 2014, available at the following link: http://www.arriva.co.uk/media/news/2014/10-04-2014

- On 9 September 2013, another wholly owned subsidiary of Arriva, Arriva Passenger Services Limited, acquired the remaining issued share capital in Centrebus Holdings. Following the acquisition, Centrebus was rebranded as Yorkshire Tiger. The CMA issued its decision in respect of this transaction on 29 May 2014[29].

18. Arriva's UK bus services are operated by individual operating companies within a divisional organisation, split into the following regional management areas:

    - Arriva North West and Wales
    - Arriva Yorkshire and North East
    - Arriva Midlands and The Shires
    - Arriva Southern Counties
    - Arriva London

19. Arriva North West and Wales and Arriva Yorkshire and North East operate bus services in the Northern Franchise area through the following operating companies:

    - Arriva Durham County Limited
    - Arriva North West Limited
    - Arriva Northumbria Limited
    - Arriva Tees & District Limited
    - Arriva Yorkshire Limited
    - Yorkshire Tiger Limited

20. Each of these companies operates bus services which may overlap with the rail services offered by the Northern Franchise.

21. Each of these regional management areas has its own dedicated senior management and commercial teams (which reports to Arriva UK Bus divisional leadership). The Arriva commercial teams are dedicated to management of Arriva bus services, route planning, timetabling, revenue management and service evolution.

[29] ME/6266-13, *Completed acquisition by Arriva Passenger Services Limited of the remainder of the entire share capital of Centrebus Holdings Limited*, Decision of 6 May 2014.