

Anticipated acquisition by First MTR South Western Trains Limited of the South Western Franchise

Decision that undertakings might be accepted

ME/6664/16

The CMA's decision under section 73A(2) of the Enterprise Act 2002 that undertakings might be accepted, given on 19 July 2017. Full text of the decision published on 24 July 2017.

Introduction

1. On 27 March 2017, the Department for Transport (**DfT**) announced that First MTR South Western Trains Limited (**FMSWTL**), a joint venture between FirstGroup plc (**First**) and MTR Corporation (**MTR** and together with First, the **Parties**), was the successful bidder for the South Western Franchise. DfT and FMSWTL entered a franchise agreement and associated agreements confirming the award of the South Western Franchise to FMSWTL (the **Franchise Award**). The South Western Franchise is due to commence on 20 August 2017 for an initial term of seven years, expiring on 18 August 2024 (subject to a possible extension of 11 reporting periods¹).
2. On 11 July 2017, the Competition and Markets Authority (**CMA**) decided under section 33(1) of the Enterprise Act 2002 (the **Act**) that it is or may be the case that the Merger consists of arrangements that are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation, and that this may be expected to result in a substantial lessening of competition (**SLC**) within a market or markets in the United Kingdom (the **SLC Decision**).
3. On the date of the SLC Decision, the CMA gave notice pursuant to section 34ZA(1)(b) of the Act to the Parties of the SLC Decision. However, the CMA did not refer the Merger for a phase 2 investigation pursuant to section 33(3)(b) on the date of the SLC Decision in order to allow the Parties the

¹ 44 weeks.

opportunity to offer undertakings to the CMA in lieu of such reference for the purposes of section 73(2) of the Act.

4. Pursuant to section 73A(1) of the Act, if a party wishes to offer undertakings for the purposes of section 73(2) of the Act, it must do so within the five working day period specified in section 73A(1)(a) of the Act. Accordingly, on 12 July 2017, the Parties offered undertakings to the CMA for the purposes of section 73(2) of the Act.
5. The CMA now gives notice, pursuant to section 73A(2)(b) of the Act, to the Parties that it considers that there are reasonable grounds for believing that the undertakings offered, or a modified version of them, might be accepted by the CMA under section 73(2) of the Act and that it is considering the offer.

The undertakings offered

6. Under section 73 of the Act, the CMA may, instead of making a reference, and for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effect which has or may have resulted from it or may be expected to result from it, accept from such of the merger parties concerned as it considers appropriate undertakings to take such action as it considers appropriate.
7. The SLC Decision found that the Merger gives rise to a realistic prospect of an SLC in relation to rail services on the flow between London and Exeter. To address this SLC, the Parties have offered to give undertakings in lieu of a reference to cap fares on the London to Exeter flow (the **Proposed Undertakings**).
8. The Proposed Undertakings will comprise:
 - (a) an undertaking to ensure that the Parties continue to maintain the same availability of advance fares on the London to Exeter flow as are available on a series of comparable flows, in relation to both GWR services and the South Western Franchise services; and
 - (b) an undertaking linking the pricing of unregulated fares offered by each of the South Western Franchise and GWR on the London to Exeter Flow to the equivalent fares offered on a series of comparable flows.
9. The Proposed Undertakings will be monitored by the CMA through reports to be provided by the Parties at each fare setting round, detailing, in particular, any changes to dedicated fares on the flow. In the monitoring reports, the Parties will be required to demonstrate compliance by providing a calculation

of actual changes in fares and ticket availability against a formula specified within the undertakings provided to the CMA. These monitoring reports will also be sent to the Department for Transport.

The CMA's provisional views

10. The CMA considers that undertakings in lieu of a reference are appropriate when they are clear-cut and capable of ready implementation. The CMA's starting point when assessing undertakings is to seek an outcome that restores competition to the level that would have prevailed absent the merger.²
11. The CMA believes that the Proposed Undertakings, or a modified version of them, might be acceptable as a suitable remedy to the SLC identified by the CMA. Specifically, the CMA believes the Proposed Undertakings will both:
 - (a) remove any ability or incentive which the Parties may have gained as a result of the Franchise Award, to raise prices on the London to Exeter flow;
 - (b) remove any ability or incentive for the Parties which the Parties may have gained as a result of the Franchise Award, to increase effective prices paid through reducing the number of advance tickets available on the London to Exeter flow.
12. As such, the Proposed Undertakings may result in replacing the competitive constraint that would have been imposed by the award of the South Western Franchise to an operator which did not raise competition concerns, which would otherwise be lost following the Merger.
13. The CMA currently believes that the Proposed Undertakings are capable of amounting to a sufficiently clear-cut and effective resolution of the CMA's competition concerns. The CMA also believes at this stage that the Proposed Undertakings may be capable of ready implementation. In particular, the ease of implementation of behavioural remedies in the context of rail franchise awards can be distinguished from the implementation of comparable remedies in mergers in other industries in a number of ways. In the case of rail franchise awards, the parties are subject to existing regulation, and there are other restrictions on the operation of rail services provided for in the franchise agreements. For these reasons, the CMA currently thinks that there

² *Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance (OFT1122)*, December 2010, Chapter 5 (in particular paragraphs 5.7–5.8 and 5.11). This guidance was adopted by the CMA (see *Mergers: Guidance on the CMA's jurisdiction and procedure (CMA2)*, January 2014, Annex D).

are reasonable grounds for believing that the Proposed Undertakings, or a modified version of them, might be accepted by the CMA under section 73(2) of the Act.

14. The CMA's decision on whether ultimately to accept the Proposed Undertakings or refer the Merger for a phase 2 investigation will be informed by, among other things, third party views on whether the Proposed Undertakings are suitable to address the competition concerns identified by the CMA.

Consultation process

15. Full details of the undertakings offered will be published in due course when the CMA consults on the undertakings offered as required by Schedule 10 of the Act.³

Decision

16. The CMA therefore considers that there are reasonable grounds for believing that the Proposed Undertakings offered by the Parties, or a modified version of them, might be accepted by the CMA under section 73(2) of the Act. The CMA now has until 20 September 2017 pursuant to section 73A(3) of the Act to decide whether to accept the undertakings, with the possibility to extend this timeframe pursuant to section 73A(4) of the Act to 15 November 2017 if it considers that there are special reasons for doing so. If no undertakings are accepted, the CMA will refer the Merger for a phase 2 investigation pursuant to sections 33(1) and 34ZA(2) of the Act.

Andrea Coscelli
Chief Executive
Competition and Markets Authority
19 July 2017

³ [CMA2](#), paragraph 8.29.