

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

Notice of possible remedies under Rule 12 of the CMA's rules of procedure for merger, market and special reference groups

Introduction

1. On 20 May 2016, the Competition and Markets Authority (CMA), in exercise of its duty under section 22(1) of the Enterprise Act 2002 (the Act), referred the completed acquisition by Arriva Rail North Limited (ARN), a wholly-owned subsidiary of Arriva plc (Arriva), of the Northern rail franchise (the Northern Franchise) (altogether the Merger) for further investigation and report by a group of CMA panel members (inquiry group).
2. In its provisional findings on the reference notified to Arriva on 9 September 2016, the CMA, inter alia, provisionally concluded that the completed Merger resulted in the creation of a relevant merger situation, and that the creation of that situation has resulted or may be expected to result in a substantial lessening of competition (SLC) on nine bus/rail routes and four rail/rail flows.
3. The bus routes and rail flows are as follows:
 - (a) for bus/rail:
 - (i) routes 3, X3/X3A and X4 in the Redcar area;
 - (ii) routes 83 and 84 in the Huddersfield area;
 - (iii) routes X14, X15 and X18 in the Ashington area; and
 - (iv) route 12 in the Darlington area;
 - (b) for rail/rail:
 - (i) Leeds to Sheffield;
 - (ii) Wakefield to Sheffield;
 - (iii) Chester to Manchester; and
 - (iv) Chester to Stockport.

4. The CMA provisionally concluded that Arriva is likely to have an incentive to increase fares post-Merger on these routes and flows.¹
5. This notice sets out the actions which the CMA considers it might take for the purpose of remedying the SLC or any resulting adverse effects identified in the provisional findings. The CMA invites comments on possible remedies by 23 September 2016.

Criteria

6. In choosing appropriate remedial action, the CMA shall have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to remedy the SLC and any adverse effects resulting from it.²
7. When deciding on an appropriate remedy, the CMA will consider the effectiveness of different possible remedies and their associated costs and will have regard to the principle of proportionality. Between two remedies that the CMA considers equally effective, it will choose that which imposes the least cost or restriction. The CMA will seek to ensure that no remedy is disproportionate in relation to the SLC and its adverse effects.³
8. Moreover, the CMA will take only those measures which are strictly necessary to safeguard or restore effective competition on the market concerned.⁴

Possible remedies on which views are sought

9. In merger inquiries, the CMA will generally prefer structural remedies, such as divestiture or prohibition, rather than behavioural remedies, for the following reasons:⁵
 - (a) structural remedies are likely to deal with an SLC and its resulting adverse effects directly and comprehensively at source by restoring rivalry;
 - (b) behavioural remedies may not have an effective impact on the SLC and its resulting adverse effects, and may create significant costly distortions in market outcomes; and

¹ The CMA provisionally concluded that the Merger has not resulted in or may not be expected to create an incentive for Arriva to degrade service quality and/or frequency on these routes.

² Section 35(3) of the Act.

³ Paragraph 1.9 of [Merger Remedies: Competition Commission Guidelines, November 2008 \(CC8\)](#). This has been adopted by the CMA board.

⁴ See Article 4(4) and 9(8) of COUNCIL REGULATION (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings. See also paragraph 18.21 of [Mergers: Guidance on the CMA's jurisdiction and procedure \(CMA2\)](#).

⁵ Paragraph 2.14 of [CC8](#).

- (c) structural remedies do not normally require monitoring and enforcement once implemented.
10. In general, one or more of the following conditions will normally apply in the unusual circumstances where the CMA selects behavioural remedies as the primary source of remedial action in a merger inquiry:⁶
- (a) Divestiture and/or prohibition is not feasible or the relevant costs of any feasible structural remedy far exceed the scale of the adverse effects of the SLC.
 - (b) The SLC is expected to have a relatively short duration (eg two to three years) due, for example, to the limited remaining term of a patent or exclusive contract.
 - (c) Relevant customer benefits are likely to be substantial compared with the adverse effects of the merger and these benefits would be largely preserved by behavioural remedies but not by structural remedies.
11. In the present case of the Northern Franchise the inquiry group's view is that the relevant costs of any feasible structural remedy far exceed the scale of the adverse effects of the SLC. Further, the CMA's view is that behavioural remedies are equally effective to address the SLC and its resulting adverse effects and will not create significant distortions in market outcomes.
12. At this stage, the inquiry group has provisionally identified the following potential behavioural remedies, which are explained in more detail in paragraphs 14 to 21 below:
- (a) In bus/rail: behavioural remedy: restriction on bus fare increases, whereby fares may on the affected routes only be increased up to a certain measure. This measure would be a suitable measure of cost inflation or a measure linked to increases in fares on other routes.
 - (b) In rail/rail: behavioural remedy: restriction on fare increases, whereby unregulated and dedicated fares on the affected flows may only be increased up to a certain measure. This measure would be linked to increases in regulated and dedicated fares on other routes, or to regulated fares on the same flow.
13. The inquiry group will consider whether any of these remedies or a combination of them (or variants of them) may be appropriate.

⁶ CC8, paragraph 2.16.

Bus/rail

Behavioural remedy: restriction on fare bus increases

14. The inquiry group has identified a behavioural remedy which would restrict bus fare increases on the routes identified, whereby fares may only be increased up to a certain measure. This measure would be a suitable measure of cost inflation or a measure linked to increases in fares on other routes.
15. The inquiry group's current view is that this remedy is likely to be effective to address the SLC that it has provisionally identified. A remedy that would restrict the increase of fares in those areas where an SLC has been provisionally identified would effectively address the SLC identified in terms of the ability and the incentives of the Parties to increase fares by directly controlling the fares.
16. The inquiry group's current view is that this remedy is also likely to be proportionate to the SLC that it has provisionally identified. This remedy is likely to be relatively simple and cheap to implement and monitor. There are various ways in which this remedy could be implemented and monitored, which will be considered in further detail in due course. This remedy would be time-limited, to the end of Arriva's ownership of the Northern Franchise.
17. The CMA invites views on whether a restriction on fare increases would be an effective and proportionate remedy. The inquiry group also invites views on:
 - (a) Against which metric (for example against a general inflation measure such as the consumer prices index (CPI), increases in fares on other routes, or an industry-specific benchmark) and against which measure (for example, against a comparable route, and if the latter, how a suitable route could be identified) fare increases should be restricted.
 - (b) Whether the restriction on fare increases should be applied across the whole route containing an overlapping flow.
 - (c) Whether the restriction on fare increases should be applied to individual fares or to a fare basket, and if the latter, how it should be defined and measured.
 - (d) Whether any restrictions should be applied to Arriva's ability to change or remove the relevant services over the period.

Rail/rail

Behavioural remedy: restriction on fare increases

18. The inquiry group has identified a behavioural remedy which would restrict fare increases on the flows identified, whereby unregulated and dedicated fares on the affected flows may only be increased up to a certain measure. This measure would be linked to increases in regulated and dedicated fares on other routes, or to regulated fares on the same flow.
19. The inquiry group's current view is that a behavioural remedy is likely to be effective to address the SLC that it has provisionally identified. A remedy that would restrict the increase of unregulated and dedicated fares in those areas where an SLC has been provisionally identified would effectively address the SLC identified in terms of the ability and the incentives of the Parties to increase fares by directly controlling the fares.
20. The inquiry group's current view is that this remedy is also likely to be proportionate to the SLC that it has provisionally identified. This remedy is likely to be relatively simple and cheap to implement and monitor. There are various ways in which this remedy could be implemented and monitored, which will be considered in further detail in due course. This remedy would be time-limited, to the end of Arriva's ownership of the Northern Franchise.
21. The CMA invites views on whether a restriction on fare increases for unregulated and dedicated fares would be an effective and proportionate remedy. The inquiry group also invites views on:
 - (a) Against which measure fare increases should be restricted, for example linked to other flows on the same route, or linked to flows on a comparable route. If linked to flows on a comparable route, how a suitable route could be identified.
 - (b) Whether the restriction on fare increases should be applied across the whole route containing an overlapping flow.
 - (c) Whether certain fare price point groups should be maintained.
 - (d) Whether the restriction on fare increases should be applied to individual fares or to fare baskets, and if the latter, how it should be defined and measured.
 - (e) Whether the remedy should be only applied to the Northern Franchise, or also to Arriva's overlapping rail franchise operations.

Other potential remedies

22. For bus operations, a structural remedy such as disposal or franchising of local operations would be effective, and could be achieved by the disposal of a depot out of which certain routes were operated. However, this remedy would most likely also include non-problematic routes, and cannot be targeted specifically at overlap routes, for commercial reasons. The inquiry group's current view is that a structural remedy, although effective, may in this case be unnecessary.
23. For rail operations, although a structural remedy is likely to be effective in order to remedy the SLC provisionally found, given the small number of flows affected relative to the total, the inquiry group's current view is that it may in this case be unnecessary.
24. However, the inquiry group will consider any views on the remedies as set out above and any other remedies put forward as part of this consultation, and will have regard as to whether any further remedies would be required.
25. The inquiry group will consider any other practical remedies that the Parties, or any interested third parties, may propose in order to remedy, mitigate or prevent the SLCs or any resulting adverse effects.
26. In determining an appropriate remedy, the inquiry group will consider the extent to which remedy options would be effective in remedying, mitigating or preventing the SLC or any resulting adverse effects that have been provisionally identified. The inquiry group will also consider whether a combination of measures is required to achieve a comprehensive solution, and will evaluate the cumulative impact of any such combination of measures on the SLC or any resulting adverse effects.

Relevant customer benefits

27. The inquiry group may have regard to the effects of remedial action on any relevant customer benefits within the meaning of section 30 of the Act arising from the merger situation.⁷ Such benefits might comprise lower prices, higher quality or greater choice of goods or services or greater innovation in relation to such goods or services. A benefit is only a relevant customer benefit if the CMA believes that: (a) the benefit has accrued as a result of the creation of the relevant merger situation concerned or may be expected to accrue within a reasonable period as a result of the creation of that situation; and (b) the

⁷ Section 35(5) of the Act.

benefit was, or is, unlikely to accrue without the creation of that situation or a similar lessening of competition.

28. The inquiry group welcomes views on the nature of any relevant customer benefits and on the scale and likelihood of such benefits and the extent to which these are preserved by the different remedy options we are considering.

Next steps

29. Interested parties are requested to provide any views in writing, including any practical alternative remedies they wish the inquiry group to consider, by 23 September 2016 (see note).
30. A copy of this notice will be posted on the CMA website.

Note

- (i) This notice of possible actions to remedy the SLC and any resulting adverse effects is given having regard to the provisional findings announced on 9 September 2016. The main parties have until 30 September 2016 to respond to the provisional findings. The inquiry group's findings may alter in response to comments it receives on its provisional findings, in which case the inquiry group may consider other possible remedies, if appropriate.