

Anticipated acquisition by Abellio East Midlands Limited of the East Midlands Franchise

Decision on relevant merger situation and substantial lessening of competition

ME/6820/19

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 19 July 2019. Full text of the decision published on 24 July 2019.

Please note that [X] indicates figures or text which have been deleted or replaced in ranges at the request of the parties or third parties for reasons of commercial confidentiality.

SUMMARY

1. On 10 April 2019, the Department for Transport (**DfT**) announced that Abellio East Midlands Limited (**AEML**), a subsidiary of Abellio Transport Group Ltd (**Abellio**), was the successful bidder for the East Midlands Franchise. DfT and AEML entered a franchise agreement confirming the award of the East Midlands Franchise to AEML (the **Franchise Award**). The East Midlands Franchise is due to commence on 18 August 2019 and run until 22 August 2027. In this decision, Abellio, AEML and the East Midlands Franchise are together referred to as the **Parties**.
2. The Franchise Award constitutes the acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. AEML and the East Midlands Franchise will therefore cease to be distinct.
3. The UK turnover of the East Midlands Franchise exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (**the Act**) is satisfied. Accordingly, the Competition and Markets Authority (**CMA**) believes that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

4. The Franchise Award also meets the thresholds under Council Regulation (EC) 139/2004 (**the EC Merger Regulation**) for review by the EU Commission (**the Commission**). Abellio submitted a reasoned submission to the Commission on 23 May 2019 requesting pre-notification referral to the CMA under Article 4(4) of the EC Merger Regulation. The CMA informed the Commission that it agreed with the referral request and considered the Franchise Award capable of being reviewed in the United Kingdom under the Act. On 21 June 2019, the Commission announced its decision to refer the Franchise Award to the CMA for review.¹ The preliminary assessment period for consideration of the Franchise Award under section 34A(2) of the Act started on 24 June 2019. The statutory 45 working day deadline for a decision is 26 August 2019.
5. Abellio, in partnership with other companies, controls three train operating companies (**TOCs**) that currently offer public transport services that overlap with the services provided by the East Midlands Franchise. These are Abellio's rail services on the Greater Anglia, West Midlands Trains, and MerseyRail franchises.² In line with its Rail Franchise Mergers Guidance (**Rail Guidance**), the CMA considered public transport as a separate product market to private transport, and considered as the geographic frame of reference the flows on which Abellio's existing rail operations overlap with the rail services on the awarded franchise.
6. The CMA has therefore assessed the impact of the Franchise Award on the operation of public transport services, in relation to all flows where the East Midlands Franchise services overlap with those of Abellio, on the basis that they are:
 - (a) flows between the same two rail stations; or
 - (b) flows between two rail stations which serve the same urban settlement.
7. The CMA reviewed 41 direct rail-on-rail overlaps between the East Midlands Franchise and Abellio's existing TOCs. The CMA believes there is no realistic prospect of a substantial lessening of competition (**SLC**) in relation to 39 of these rail-on-rail overlaps. However, the CMA believes that the Franchise Award does give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on the Norwich to Ely and on the Thetford to Ely overlaps.

¹ European Commission Decision: M.9356 – *Abellio/East Midlands Passenger Rail Franchise*, 21 June 2019.

² Abellio does not operate any bus or coach services in any of the overlap areas. Therefore, bus and coach services are not considered further in the frame of reference or the competitive assessment of the Franchise Award.

8. The CMA believes that the closeness of competition between the overlapping services, the absence of other rail competitors on the flow, and the fact that the Parties have both the ability and incentive to raise fares indicate that the Franchise Award gives rise to a realistic prospect of an SLC on the Norwich to Ely and on the Thetford to Ely flows.
9. The CMA is therefore considering whether to accept undertakings under section 73 of the Act. The Parties have until 26 July 2019 to offer an undertaking to the CMA that might be accepted by the CMA. If no such undertaking is offered, then the CMA will refer the Franchise Award pursuant to sections 33(1) and 34ZA(2) of the Act.

ASSESSMENT

Parties

10. The Franchise Award relates to the award of the East Midlands Franchise to AEML.
11. AEML is a wholly owned subsidiary of Abellio, which operates rail and bus services in the United Kingdom.
12. Abellio is owned by Abellio Transport Holding BV and ultimately owned by NV Nederlandse Spoorwegen (**NS Groep**), the Dutch-state-owned holding company of a multinational passenger transport group operating in the Netherlands, Germany and the United Kingdom.
13. In the UK, Abellio also currently operates rail franchises including:
 - (a) West Midlands Trains, in which Abellio holds a 70.1% shareholding and Mitsui and JRE hold the remainder (14.95% each).
 - (b) Greater Anglia, in which Abellio holds a 60% shareholding and Mitsui holds the remaining shareholding.
 - (c) MerseyRail, in which Abellio holds a 50% shareholding and Serco holds the remaining shareholding.
14. The franchise includes the Midland Main Line, with its terminus at London St Pancras running services to Derby, Leicester, Sheffield and Nottingham. It also includes a network of local lines serving destinations such as Norwich, Grantham, Lincoln and Mansfield. The predecessor East Midlands rail franchise (operated by Stagecoach) generated revenues of £384.7 million in 2018.

Transaction

15. Pursuant to the Franchise Award, AEML will come to operate and control the East Midlands Franchise.
16. AEML's operation of the East Midlands Franchise will commence on 18 August 2019.

Procedure

17. The Franchise Award was considered at a Case Review Meeting.³

Jurisdiction

18. The Franchise Award constitutes the acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. AEML and the East Midlands Franchise will therefore cease to be distinct.
19. The UK turnover of the East Midlands Franchise exceeds £70 million, so the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the **Act**) is satisfied. The CMA therefore believes that it is or may be the case that arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation.
20. As noted in paragraph 4, the Franchise Award meets the thresholds under the EC Merger Regulation for review by the Commission. Abellio submitted a reasoned submission to the Commission on 23 May 2019 requesting pre-notification referral to the CMA under Article 4(4) of the EC Merger Regulation. The CMA informed the Commission that it agreed with the referral request and considered the Franchise Award capable of being reviewed in the United Kingdom under the Act. On 21 June 2019, the Commission announced its decision to refer the Franchise Award to the CMA for review.⁴
21. The initial period for consideration of the Merger under section 34ZA(2) of the Act started on 24 June 2019 and the statutory 45 working day deadline for a decision is therefore 26 August 2019.

Counterfactual

22. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). In accordance with the

³ See *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, from paragraph 7.34.

⁴ European Commission Decision: M.9356 – *Abellio/East Midlands Passenger Rail Franchise*, 21 June 2019.

CMA's Rail Guidance, in rail franchises, the pre-merger situation cannot be the appropriate counterfactual, as the existing rail franchise will terminate and so there cannot be an expectation that the current operator would continue to operate the franchise.⁵ The CMA therefore treats the appropriate counterfactual as the award of the franchise to a TOC that raises no competition concerns.⁶ Accordingly, the CMA believes it appropriate to assess the Franchise Award against a counterfactual whereby the East Midlands Franchise is awarded to a TOC raising no competition concerns.

Frame of reference

23. Market definition provides a framework for assessing the competitive effects of a merger and involves an element of judgement. The boundaries of the market do not determine the outcome of the analysis of the competitive effects of the merger, as it is recognised that there can be constraints on merging parties from outside the relevant market, segmentation within the relevant market, or other ways in which some constraints are more important than others. The CMA will take these factors into account in its competitive assessment.⁷
24. Abellio operates public transport services that overlap with the services provided by the East Midlands Franchise. These include Abellio's West Midlands, Greater Anglia, and MerseyRail rail services.

Product scope

Competition for the market

25. In line with previous decisional practice, most recently *First MTR / South Western*⁸ and *Arriva / Northern*,⁹ the CMA considers that the relevant frame of reference for competition for the market is the award of rail franchises.

⁵ [Rail franchise mergers - Review of methodologies and guidance](#) (CMA74), para. 5.2.

⁶ [Rail Guidance](#), para. 5.4.

⁷ [Merger Assessment Guidelines](#), paragraph 5.2.2.

⁸ *First MTR / South Western*, paragraph 24.

⁹ *Arriva / Northern*, Final report of 2 November 2016, paragraphs 6.4-6.7.

Competition in the market

26. In previous decisional practice, as discussed in the Rail Guidance, the CMA has not found it necessary to conclude whether a specific mode of transport, other than public transport, is part of the relevant market.¹⁰
27. The CMA has not received any evidence to suggest that a departure from its Rail Guidance would be appropriate in the present case.
28. The CMA has therefore adopted as the product frame of reference the provision of all public transport services on a particular flow.

Geographic scope

Competition for the market

29. Rail franchises are awarded across Great Britain. In line with previous decisional practice, the CMA therefore considers that the appropriate geographic frame of reference for competition for the market is national.

Competition in the market

30. Passengers travel between a specific point of origin and a specific point of destination, described as a 'flow'. In previous decisional practice, as discussed in its Rail Guidance, the CMA has defined the geographic frame of reference in rail franchise mergers by identifying the Franchisee's overlapping flows. The CMA generally defines overlapping flows as rail services between the same two rail stations or the same two settlements.¹¹
31. The CMA has not received any evidence to suggest that a departure from its guidance would be appropriate in the present case.
32. Each flow is typically just one possible journey on a route, ie a series of stations served by a given train in sequence, and franchises typically cover only a small number of those routes. For example, the 41 overlap flows at issue in this case are served by only two of the East Midlands Franchise routes: Norwich to Liverpool and Crewe to Derby. The fact that different flows are served as part of a single route may affect the CMA's competitive assessment. While fares are set separately for each flow, there are aspects of quality that can only be varied for the entire route, such as service frequency

¹⁰ Rail Guidance, paragraph 4.5. Where relevant, the CMA instead takes the mode into account in its competitive assessment.

¹¹ Rail Guidance, paragraph 4.8.

or the quality of rolling stock. However, this is taken into account where relevant in the competitive assessment.

33. Since fares and other competitive conditions are generally identical on a journey from A to B and the reverse journey from B to A, the CMA assesses both directions of a flow together, ie all reference to a flow from A to B also include the reverse journey.
34. The CMA has therefore considered the impact of the Franchise Award on all flows that overlap with the East Midlands Franchise services, on the basis that they are:
 - (a) flows between the same two rail stations; or
 - (b) flows between two rail stations which serve the same settlement.

Conclusion on frame of reference

35. For the reasons set out above, the CMA has considered the impact of the Franchise Award in relation to public transport operators on all flows that overlap with the East Midlands Franchise services, on the basis that they are:
 - (a) flows between the same two rail stations, or
 - (b) flows between two rail stations which serve the same settlement.

Competitive assessment

Competition for the market

36. The CMA considers that competition for the market could be affected by the Franchise Award if it could lead to a reduction in the number of bidders available for future rail franchise bids, or provide Abellio with an incumbency advantage relative to other bidders in future bids for franchises.
37. The CMA considers that the award of the East Midlands Franchise will have no impact on competition for the award of future franchises, on the basis that:
 - (a) the award of the East Midlands Franchise to AEML would not reduce the number of bidders for future franchises;
 - (b) Abellio would not obtain incumbency advantages for future franchises through the acquisition of the East Midlands Franchise; and
 - (c) the combined share of franchises Abellio already holds and the increment obtained through the award of the East Midlands Franchise are not

significant, with Abellio estimating a combined share of 21%, in terms of turnover, with an increment of 4%.

38. In addition, 13 different TOCs currently hold UK rail franchises.¹² 18 different TOCs currently hold pre-qualification questionnaire (PQQ) passports for rail franchising covering all rail franchise competitions held between September 2015 and September 2019. The CMA is aware of at least 11 bidders, either individually or in combination, who have contested in the most recent 6 franchise competitions.¹³ Therefore, the CMA does not consider that the award of this franchise to AEML (as a subsidiary of Abellio) would significantly affect competition for any future franchise. No third parties raised concerns about the impact of the Franchise Award on competition for the market.
39. The CMA therefore believes, for the reasons set out above, that there is no realistic prospect of an SLC with respect to competition for the market for rail franchises as a result of the Franchise Award.

Competition in the market

Horizontal unilateral effects

40. Horizontal unilateral effects may arise when one firm merges with a competitor that previously provided a competitive constraint, allowing the merged firm profitably to raise prices or degrade quality on its own and without needing to coordinate with its rivals.¹⁴ Horizontal unilateral effects are more likely when the merger parties are close competitors.
41. The CMA assessed whether it is or may be the case that the Franchise Award has resulted, or may be expected to result, in an SLC in relation to unilateral horizontal effects in relation to the rail-on-rail overlaps referred to in paragraph 30 above. The CMA's analysis is set out below.
42. The concern under this theory of harm is that the common ownership of overlapping rail services could give Abellio the ability and incentive to increase fares and/or reduce non-price aspects of rail services (such as service quality) on the overlapping rail flows on its respective franchises. Any reference to an increase in fares hereafter should be read to include the possibility of keeping headline fares the same but making fewer seats available for the cheaper fare, or dropping a particular type of ticket (eg

¹² Abellio, First Group, Arriva, Go-Ahead, Stagecoach, Keolis, Virgin, MTR, Mitsui/JRE, Trenitalia, Serco and Amey, UK Government.

¹³ Including the East Midlands, South Eastern, West Coast Partnership, South Western, West Midlands, and Wales and Borders.

¹⁴ [Merger Assessment Guidelines](#), paragraph 5.4.1.

Advance ticket) altogether where available. This is on the basis that, after the Franchise Award, it would be less costly for Abellio to raise prices (or lower quality) because it would recoup profit on recaptured sales from customers who would have switched to the overlapping rail service.

43. The below discussion focuses on fare-related theories of harm. However, there are non-fare aspects of a flow or route that might be important in the assessment of the Franchise Award effects. There are in principle various aspects of rail quality that could be varied (to reduce costs), such as service frequency or the quality of rolling stock. However, it is in most cases difficult to vary quality on an individual flow without affecting the entire route, and most rail-on-rail overlaps, including those relevant in this case, only take up a subset of the route; therefore, the incentive to vary quality is reduced. Secondly, franchise contracts generally restrict the ability of the TOC to adjust service quality considerably.¹⁵
44. Abellio submitted that the Rail Guidance indicates that it will in most cases be difficult to vary quality on an individual flow without affecting the entire route. Abellio submitted that this is also the case for the relevant flows in the present case which account for a small percentage of the relevant East Midlands Trains service that overlaps with the services of Abellio's other franchises.
45. On that basis, and the fact that the franchise agreement between DfT and AEML restricts Abellio's ability to adjust service quality levels, the CMA therefore believes that Abellio would not have the ability or incentive to adjust service quality and focussed on the fare-related theory of harm outlined below.
46. The specific fare-related theory of harm that is relevant for a given flow in this case depends on whether one or more TOCs on that flow has a dedicated fare, ie a fare that is only valid for a service specific to that TOC, and on which TOC is the fare setter for the inter-available fares on that flow (fares available on both TOCs). This is discussed further for the individual flows below.

Framework for assessment

47. The focus of the CMA's assessment is on whether the Franchise Award may result in horizontal unilateral effects in relation to flows on which the East Midlands Franchise overlaps with Abellio's existing rail operations.

¹⁵ In *Arriva / Northern*, the CMA analysed parts of the Franchise Agreement and discussed issues around quality and the franchise agreement with DfT and found that, because of the strongly regulated quality, a service quality-related theory of harm was unlikely (see paragraphs 8.35-8.50).

48. The Parties identified 41 direct overlap flows. The CMA also considered whether there were (a) plausible indirect routes which would give rise to an overlap, or (b) significant population centres which would have the choice of using either the East Midlands Franchise or an overlapping franchise operated by Abellio (ie where those passengers with a choice would constitute a significant proportion of passengers on the relevant flows), which might give rise to realistic competition concerns. The CMA did not identify any such competition concerns.
49. In line with the Rail Guidance, the CMA undertook a filtering methodology to exclude from further analysis overlapping flows on which an SLC is least likely. 28 flows were removed by the Small Flows filter¹⁶, and one further flow was removed by the Effective Competitor filter.¹⁷
50. Following the application of these filters, 12 rail-on-rail overlaps remained for further assessment, including eight where no third-party TOC is present. Of these 12 flows, six were on the Norwich to Ely to Peterborough route, where East Midlands' services overlap with Abellio's existing Greater Anglia services. Five flows were on the Stoke-on-Trent to Crewe route, where East Midlands' services overlap with Abellio's existing West Midlands services. The remaining flow was between Liverpool South Parkway and Liverpool BR,¹⁸ where East Midlands' services overlap with Abellio's existing West Midlands and MerseyRail services. The CMA undertook a detailed assessment of the remaining flows to assess whether there is a realistic prospect of an SLC.
51. In relation to nine of the 12 remaining flows, neither the East Midlands Franchise nor the overlapping Abellio service currently offers a dedicated fare, and internal documents obtained from both Abellio and the current operator of the East Midlands Franchise indicate that neither Abellio nor the East Midlands Franchise had plans to introduce new dedicated fares.
52. On these flows, all tickets are inter-available, meaning that one franchise is the designated fare setter for the flow, and every ticket is valid for travel on either service, with the revenues being divided between the two franchises in fixed proportions rather than actual passenger journeys. In this situation, the CMA considers that there is currently no price competition between the two

¹⁶ The CMA will generally filter out rail flows with less than £20,000 of revenue per annum. See paragraph 6.39 of the Rail Guidance.

¹⁷ The CMA will filter out flows where at least one third party rail operator has a revenue share on the flow of at least 50%. See paragraph 6.51 of Rail Guidance.

¹⁸ Liverpool BR is a station group code for Liverpool James Street, Liverpool Central, Liverpool Lime Street and Liverpool Moorfields. Liverpool BR tickets are valid for travel to/from any of these stations in the centre of Liverpool.

franchises and, based on evidence from internal documents, there are no plans for price competition.

53. Since the East Midlands Franchise and the overlapping Abellio services are currently under separate control the CMA considers that this represents the relevant counterfactual with respect to competition on these flows.¹⁹ Given the absence of price competition (including plans for price competition) in the counterfactual, there would be no change in the fare setter's incentives if the two franchises come under common control. The CMA therefore believes that there is no realistic prospect of an SLC on these nine flows.
54. As regards the Liverpool South Parkway and Liverpool BR flow, the East Midlands Franchise overlaps with Abellio's MerseyRail and West Midlands Trains franchises. Of these services only MerseyRail offers a dedicated fare, and is also the fare setter for inter-available fares. Northern and Transport for Wales also operate on this flow and both of these TOCs offer a dedicated fare.
55. The CMA might in principle have concerns that, post-Franchise Award, MerseyRail might increase the price of its dedicated fare, reduce the number of tickets available, or remove it entirely, benefitting from higher fares but also recapturing those passengers who switched to other Abellio franchises. However, this dedicated fare takes the form of a zonal ticket for a wider area and the overlapping flow represents only a very small part (less than 5%) of the total revenue for that zonal ticket. The CMA therefore believes that there is no realistic prospect that the price of the zonal ticket might be changed in response to a change in competitive conditions on a single flow, especially given the presence of competing TOCs offering dedicated fares.²⁰ Consequently, the CMA believes that there is no realistic prospect of an SLC on this flow.
56. The remaining flows which the CMA assessed (as described below) were Norwich to Ely and Thetford to Ely. On both of these flows, dedicated fares are available, and therefore the CMA considers that there is competition between the franchises prior to the Franchise Award.
57. The CMA notes that the Norwich to Ely flow and any shorter flows involving one or more of the intermediate stations²¹ are served by only two TOCs, Greater Anglia and East Midlands Trains. Both of these TOCs will be operated by Abellio post-Franchise Award. With the exception of the Norwich

¹⁹ Rail Guidance, paragraph 6.49.

²⁰ Mersey Travel told the CMA that [§].

²¹ Brandon (only served by the Greater Anglia Franchise), Thetford, Harling Road, Eccles Road, Attleborough and Wymondham.

to Ely and Thetford to Ely flows, the remaining flows in this area did not raise competition concerns either because they were excluded by the Small Flows filter (see paragraph 49) or because of the lack of competition pre-Franchise Award (see paragraphs 51-53). The CMA has considered this context as appropriate in its assessment of the Norwich to Ely and Thetford to Ely flows.²²

Norwich to Ely

58. Between Norwich and Ely, the East Midlands Franchise and Greater Anglia Franchise both operate an hourly service. After the Franchise Award, both franchises will be controlled by Abellio, leaving no third party TOCs on this flow.
59. The East Midlands Franchise is the fare setter on this flow. The East Midlands Franchise sells advance tickets on this flow that are dedicated to its own service and cannot be used on the Greater Anglia Franchise trains. The Greater Anglia Franchise does not have such tickets. Dedicated fares represent 11% of total revenue for this flow (around £50,000 per year).
60. One common reason for dedicated fares is to compete to attract passengers away from inter-available tickets: a TOC would receive the whole revenue from a passenger using a dedicated fare, but only a proportion of the revenue from a passenger using an inter-available ticket. Therefore, the CMA believes that the East Midlands Franchise's dedicated fare is currently set to compete with the Greater Anglia service. However, following the Franchise Award, the franchises controlled by Abellio would receive the whole revenue from inter-available tickets. The CMA's concern is therefore that Abellio may have an ability and incentive to either increase the price of the dedicated fare or to remove the dedicated fare, or to reduce the number of tickets available,²³ since Abellio would benefit from both higher priced dedicated fares and from any customers who switch to the inter-available fare (and travel on either franchise) as a result.
61. The CMA also considered whether Abellio might have an incentive to increase the inter-available fares for this flow. In that regard, the CMA notes that the East Midlands Franchise currently sets those fares without regard for any dedicated fares set by Greater Anglia, since no such fares exist. Instead, the East Midlands Franchise's setting of inter-available fares is based on overall

²² For example, when considering submissions that split-ticketing or travelling short might constrain Abellio on the Norwich to Ely and Thetford to Ely flows.

²³ Dedicated fares are often advance tickets, where a certain volume of tickets are available at a particular price point for a particular train. There may be multiple price points, each with an associated volume. Neither the price nor the volume is regulated.

demand conditions that will not change as a result of the Franchise Award. Therefore, the CMA does not believe that the Franchise Award will affect the inter-available fares on this flow.

Closeness of competition

62. The journey times of the East Midlands and Greater Anglia services are very similar. Greater Anglia takes 60 minutes compared to East Midlands' 52 minutes, because the former service stops at more stations. The generalised journey cost of the Greater Anglia service is 4% higher, and this difference is well below the 25% threshold mentioned in the Rail Guidance over which the CMA would be unlikely to find a competition problem.²⁴
63. Therefore, the CMA believes that the East Midlands and Greater Anglia services between Norwich and Ely are close substitutes.²⁵

Ability and incentive to increase fares

64. The Standard Weekly Season ticket and the Off-peak Return ticket on this flow are regulated, meaning that their prices cannot rise by more than RPI. These regulated fares make up to 37% of total revenue for this flow. No other fares are regulated.
65. Abellio submitted that it did not have a meaningful ability or incentive to increase other fares because:
- (a) Greater Anglia is operated by a JV between Abellio and Mitsui. Abellio said that the relationship between the JV partners was important, and that Mitsui would be able to withhold approval for other key matters to retaliate against any changes in fares that would disadvantage it. Therefore, Abellio would not increase fare prices;
 - (b) The possibility of split ticketing and travelling short constrained its fares on this flow;²⁶

²⁴ The generalised journey cost takes into account fare, journey duration, train frequency and interchanges to compare the total 'cost' of different services (see Rail Guidance, paragraph 7.45, which states that the CMA would be unlikely to find a competition problem on flows which have a GJC difference of greater than 25% for all calculated values of GJC).

²⁵ This is also reflected in the high revenue retention ratio, estimated by the Parties using MOIRA, of 78%. See Rail Guidance, paragraph 7.37, for an explanation of revenue retention ratios. As explained there, the CMA will generally not find a competition problem on a flow where the ratio is below 50%, which is well below the level here.

²⁶ Travelling short means travelling from A to B using a ticket from A to C, which is on the same route, further away than B is. Split ticketing means travelling from A to B using two tickets, one from A to an intermediate station and another ticket from there to B.

- (c) Its pricing was constrained by the regulated fares on this flow;
 - (d) Its pricing was constrained by the likely reduction in demand that would follow a fare increase;
 - (e) Its pricing was constrained by the desire to use different fares for demand management purposes, i.e. to incentivise passengers to avoid travelling during peak hours if possible; and
 - (f) Its pricing was constrained by the need to maintain good relationships with key stakeholders such as local authorities and the Department for Transport.
66. The CMA considers that the fact that Greater Anglia is operated by a JV is not relevant for its assessment, since Greater Anglia does not set any fares on this flow, and Greater Anglia would benefit from any increase in East Midlands dedicated fares.
67. With regard to the constraint from split ticketing and travelling short, Abellio did not present evidence showing that a material number of passengers would be likely to take up these options on this flow in response to a fare increase. The CMA also notes that this may not be a constraint unless there are strong constraints on fares on the relevant similar flows; otherwise, it could be that the neighbouring flows themselves would also see their fares be affected by the loss of competition on this flow. As noted at paragraph 57, there are no third party TOCs active on any flows that passengers might use for these purposes,²⁷ and the only part of this journey with an available dedicated fare is Thetford-Ely.
68. As Abellio's analysis shows, the constraint from regulated fares is quite weak on this flow, since the only regulated fares are the Weekly Season ticket and the Off-peak Return. This means that, for example, the price of the Anytime Return ticket on this flow could theoretically be increased up to the level of the Weekly Season ticket, providing a headroom which represents an increase of 189%. Therefore the CMA considers that Abellio has an ability to increase fares.
69. Abellio did not present evidence regarding the likely price elasticity of demand which was specific to this flow. However, it submitted that a range of assumptions could be made about customer switching and that the elasticity recommended by the Passenger Demand Forecasting Handbook could be used to assess the switching that could follow a price rise. The CMA does not

²⁷ Neighbouring flows have been cleared on the basis of their size or the lack of competition in the counterfactual, rather than competitive constraints.

consider that it would be appropriate to simply apply the average estimate from the Passenger Demand Forecasting Handbook to this flow. However, the CMA did consider a range of assumptions about possible customer switching following a price increase when considering Abellio's incentives to increase prices on this flow. The CMA considered that this analysis indicated that Abellio would have an incentive to increase prices on this flow. Furthermore, the CMA notes that Abellio would benefit from any price increases for the duration of the Franchise (which runs until 2027).

70. The CMA accepts that Abellio's ability to increase prices may be constrained to some extent by the need to maintain price differences between off-peak and anytime tickets, and the need to maintain good relationships with key stakeholders such as local authorities and the DfT. Therefore, the CMA applied a sensitivity to its estimates of the Parties' incentives, assuming for purposes of illustration that no individual fare could increase by more than 30%. The CMA has concluded that Abellio would still have an incentive to increase fares materially even under the sensitivities most favourable to it.
71. Moreover, the CMA notes that the stakeholder management point is less relevant for theories of harm that concern advance tickets, since the pricing of those tickets is typically less transparent to passengers. This is, for example, because TOCs can adjust the number of advance tickets available, a change which is difficult for consumers to observe.
72. Finally, the CMA notes that it is typically not costly to change fares or available dedicated ticket numbers on rail services, since all fares are updated annually or more frequently. The gain from doing so could be significant (up to £98,335 per year at current fares, or less depending on passenger response; over the life of the franchise, this could be around £800,000). The CMA therefore considers that Abellio would have the incentive to increase fares.

Conclusion

73. Since East Midlands and Greater Anglia are each other's closest and only competitors on the Norwich to Ely flow, and since Abellio will have both the ability and the incentive to substantially increase dedicated fares after the Franchise Award, the CMA believes that the Franchise Award raises significant competition concerns on the Norwich to Ely flow.

Thetford to Ely

74. Between Thetford and Ely, East Midlands and Greater Anglia both operate an hourly service. After the Franchise Award, both franchises will be controlled by Abellio, leaving no third party TOCs on this flow.

75. Greater Anglia is the fare setter for inter-available fares on this flow. East Midlands sells advance tickets for this flow that are dedicated to its own service; they cannot be used on Greater Anglia trains. Greater Anglia does not have such tickets. Dedicated fares represent 2% of total revenue for this flow (around £1,300 per year).
76. The CMA has two concerns about this flow. The first is that, as with Norwich to Ely, Abellio may have an ability and incentive to either increase the price of the dedicated fare or to remove the dedicated fare, or to reduce the number of tickets available, since Abellio will benefit from both higher fares and from any customers who switch to its inter-available tickets as a result.
77. The CMA's second concern is that Abellio may have an ability and incentive to increase the inter-available fares for this flow. Currently, dedicated fares on the East Midlands Franchise compete to attract passengers from the Greater Anglia services and may therefore constrain the inter-available fare set by Greater Anglia. After the Franchise Award, Greater Anglia would no longer feel constrained by the dedicated fares (if they still existed).
78. Dedicated fares currently account for only 2% of the revenue on this flow. However, as set out in paragraph 6.43(b) of the Rail Guidance, if dedicated fares are available but little used, it may be that they are constraining inter-available fares (ie dedicated fares would attract more passengers if inter-available fares rose) and therefore such fares are more important to competition than their usage may suggest. Therefore, the CMA considers that, after the Franchise Award, Abellio may have an ability and incentive to increase the inter-available fare as well.²⁸

Closeness of competition

79. The journey times of the East Midlands and Greater Anglia services are very similar. Greater Anglia takes 25 minutes compared to East Midlands' 22 minutes, because the former stops in Brandon while East Midlands only does so once a day. The generalised journey cost of the Greater Anglia service is 3% higher, and this difference is well below the 25% threshold mentioned in the Rail Guidance over which the CMA would be unlikely to find a competition problem.²⁹

²⁸ This contrasts to the CMA's view on the Norwich to Ely flow. The difference between the two flows is that on the Norwich to Ely flow a single TOC sets both the dedicated and inter-available fare, while on the Thetford to Ely flow the dedicated and inter-available fares are set by different TOCs.

²⁹ See footnote 24.

80. Therefore, the CMA believes that the East Midlands and Greater Anglia services between Norwich and Ely are close substitutes.³⁰

Ability and incentive to increase fares

81. The Standard Weekly Season ticket and the Anytime Day Return ticket on this flow are regulated, meaning that their prices cannot rise by more than RPI. These regulated fares make up 28% of total revenue for this flow.
82. Abellio submitted that it did not have a meaningful ability to increase unregulated fares because:
- (a) Greater Anglia is operated by a JV between Abellio and Mitsui. Abellio said that the relationship between the JV partners was important, and that Mitsui would be able to withhold approval for other key matters to retaliate against any changes in fares that would disadvantage it. Therefore, Abellio would not increase fare prices;
 - (b) The possibility of split ticketing and travelling short constrained its fares on this flow;
 - (c) Its pricing was constrained by the regulated fares on this flow;
 - (d) Its pricing was constrained by the likely reduction in demand that would follow a fare increase;
 - (e) Its pricing was constrained by the desire to use different fares for demand management purposes, i.e. to incentivise passengers to avoid travelling during peak hours if possible; and
 - (f) Its pricing was constrained by the need to maintain good relationships with key stakeholders such as local authorities and the Department for Transport.
83. Abellio also submitted that its maximum plausible gain from increasing fares was small.
84. The CMA considers that the fact that Greater Anglia is operated by a JV is not relevant for its assessment, since Abellio's JV partners are unlikely to object to a set of fare changes that would make both TOCs more profitable.
85. The CMA's approach to assessing the constraint from split ticketing and travelling short was already discussed above at paragraph 67. The CMA

³⁰ This is also reflected in the high revenue retention ratio, estimated by the Parties using MOIRA, of 69%. See footnote 25.

notes that Abellio did not present evidence showing that a material number of passengers on this flow would take up these options in response to a fare increase. Moreover, as noted at paragraph 57, there are no third party TOCs active on any flows that passengers might use for these purposes, and no advance fares are available for intermediate journeys between Thetford and Ely.

86. As Abellio's analysis shows, the constraint from regulated fares is stronger on this flow than it is on Norwich to Ely, since it is the Anytime Day Return fare that is regulated rather than the Off-peak Day Return fare. This means, for example, that none of the day return fares can be increased to more than £13.40, the current price of an Anytime Day Return for this flow. However, this still allows for a 10% increase in the Off-peak Day Return and a 22% increase in the price of the Anytime Day Single. The headroom for advance tickets is greater still. Therefore, the CMA considers that Abellio has an ability to increase fares.
87. Abellio did not present evidence regarding the likely price elasticity of demand which was specific to this flow. However, it submitted that a range of assumptions could be made about customer switching and that the elasticity recommended by the Passenger Demand Forecasting Handbook could be used to assess the switching that could follow a price rise. The CMA does not consider that it would be appropriate to simply apply the average estimate from the Passenger Demand Forecasting Handbook to this flow. However, the CMA did consider a range of assumptions about possible customer switching following a price increase when considering Abellio's incentives to increase prices on this flow. The CMA also recognises that the total revenue associated with this flow is relatively low and, as described at paragraph 86, the constraint from regulated fares is greater on this flow than on the Norwich to Ely flow. However, the CMA considers that the analysis indicated that Abellio would still have sufficient incentive to increase prices on this flow. Furthermore, the CMA notes that Abellio would benefit from any price increases for the duration of the Franchise (which runs until 2027).
88. The CMA accepts that Abellio's ability to increase prices may be constrained to some extent by the need to maintain price differences between off-peak and anytime tickets, and the need to maintain good relationships with key stakeholders such as local authorities and the DfT. Therefore, the CMA applied a sensitivity to its estimates of the Parties' incentives, assuming for purposes of illustration that no individual fare could increase by more than 30%. The CMA has concluded that Abellio would still have an incentive to increase fares materially even under the sensitivities most favourable to it.

89. Moreover, the CMA notes that the stakeholder management point is less relevant for theories of harm that concern advance tickets, since the pricing of those tickets is typically less transparent to passengers. This is, for example, because TOCs can adjust the number of advance tickets available, a change which is difficult for consumers to observe.
90. The CMA considers that Greater Anglia currently sets the inter-available fares for this flow with the aim of avoiding too many passengers opting for East Midlands' dedicated fares instead. That is, East Midlands currently constrains Greater Anglia's fares setting. This is the case even though East Midlands' dedicated fares only represent a small share of total revenue for this flow. As noted in paragraph 6.43(b) of the Rail Guidance, it may be that the popularity of the dedicated fares would quickly increase if Greater Anglia increased the inter-available fares, meaning that East Midlands' dedicated fares may well be a stronger constraint than the revenue figures suggest.
91. Finally, the CMA again notes that it is typically not costly to change fares or available ticket numbers on rail services. The gain from doing so would be smaller than on Norwich-Ely (up to around £8,000 per year at current fares, or less depending on passenger response; over the life of the franchise, this could be around £65,000), but still potentially worthwhile. The CMA notes that the existing dedicated fare which was introduced on the Norwich to Ely flow in 2018 by the current franchise holder, indicates that that TOC found it worthwhile to introduce a dedicated fare despite deriving relatively small revenue from it. The CMA therefore considers that Abellio would have the incentive to increase fares.

Conclusion

92. Since East Midlands and Greater Anglia are each other's closest and only competitors on the Thetford to Ely flow, and since Abellio will have both the ability and the incentive to substantially increase dedicated and inter-available fares after the Franchise Award, the CMA believes that the Franchise Award gives rise to raises significant competition concerns on the Thetford to Ely flow.

Conclusion on horizontal unilateral effects

93. For the reasons set out above, the CMA believes that East Midlands and Greater Anglia are currently each other's only competitors on the Norwich to Ely and Thetford to Ely flows. Bringing both of these franchises under the control of Abellio will give it the ability and incentive to increase East Midlands' dedicated fares for the Norwich to Ely flow and all non-regulated fares for the Thetford to Ely flow.

94. Accordingly, the CMA found that the Franchise Award raises significant competition concerns as a result of horizontal unilateral effects in relation to the Norwich to Ely, and Thetford to Ely flows.

Barriers to entry and expansion

95. Entry, or expansion of existing firms, can mitigate the initial effect of a merger on competition, and in some cases may mean that there is no SLC. In assessing whether entry or expansion might prevent an SLC, the CMA considers whether such entry or expansion would be timely, likely and sufficient.³¹
96. Abellio did not make any submissions on the prospects for entry or expansion of public transport services on the relevant flows. The CMA has not received any other evidence to suggest that, in respect of the overlapping flows, it would be appropriate to depart from its Rail Guidance which finds that barriers to entry or expansion on rail services are typically high. The CMA therefore does not believe that entry or expansion in public transport services would be sufficient, timely or likely to prevent a realistic prospect of an SLC as a result of the Franchise Award.

Third party views

97. The CMA contacted local authorities and competitors of Abellio, and relevant local authorities. Only one local authority in the Norwich-Ely region raised concerns that the Franchise Award could result in smaller numbers of services and higher fares, given that there are price differences currently. Another local authority expressed concerns regarding the impact of the Franchise Award on the passenger timetable. The CMA notes that the timetable is regulated and that, therefore, the Franchise Award will not affect the timetable or number of services. Concerns about fares have been addressed above where relevant. Finally, one member of the public raised a concern about the choice for customers who may choose which station to drive to before taking a train.³²
98. No other third parties raised concerns about the Franchise Award.
99. Third party comments have been taken into account where appropriate in the competitive assessment above.

³¹ [Merger Assessment Guidelines](#), from paragraph 5.8.1.

³² See paragraph 48.

Conclusion on substantial lessening of competition

100. Based on the evidence set out above, the CMA believes that it is or may be the case that the Franchise Award may be expected to result in an SLC as a result of horizontal unilateral effects in relation to public transport services between Norwich to Ely, and Thetford to Ely.

Exceptions to the duty to refer

101. Where the CMA's duty to refer is engaged, the CMA may, pursuant to section 33(2)(a) of the Act, decide not to refer the merger under investigation for a Phase 2 investigation on the basis that the market(s) concerned is/are not of sufficient importance to justify the making of a reference (the ***de minimis*** exception). The CMA has considered below whether it is appropriate to apply the *de minimis* exception to the present case.
102. Abellio submitted that the CMA should exercise its discretion not to refer, as the customer detriment resulting from the Franchise Award would be so small that the initial and ongoing costs (to Abellio and to the CMA) of undertakings in lieu would be disproportionate. In relation to the Thetford to Ely flow, Abellio submitted that the maximum potential additional customer spend from all fares being increased is £8,179 per year, and even smaller for more plausible increases (eg assuming Off-peak Day Return fares would remain below the regulated Anytime Day Return fare). In relation to the Norwich to Ely flow, Abellio submitted that plausible increases would represent relatively low amounts.
103. The CMA's general policy, regardless of the size of the affected market, is not to apply the *de minimis* exception where clear-cut undertakings in lieu of a reference could, in principle, be offered by the parties to resolve the concerns identified.³³ In this case, the CMA has identified an SLC in relation to two rail-on-rail overlaps only. While the CMA is generally unlikely at Phase 1 to consider that behavioural remedy offers will be sufficiently clear-cut to address the identified competition concerns, the CMA does not inevitably refuse behavioural remedy offers, in particular where divestment would be clearly impractical or is otherwise unavailable.³⁴ In respect of rail-rail overlaps, the CMA has previously accepted undertakings in lieu of reference in the form of a price cap as sufficiently clear-cut in *FirstGroup / South Western* and in *Stagecoach / Eastern Franchise*. Similar undertakings were accepted in Phase 2 in *Arriva / Northern*. The CMA has not received any evidence to

³³ *Mergers: Exceptions to the duty to refer*, CMA64, December 2018, paragraph 28.

³⁴ *Merger remedies*, CMA 87, December 2018, paragraph 3.32.

suggest that similar undertakings would not be available to resolve the SLC identified in relation to the Norwich to Ely, and the Thetford to Ely flows in this case. The CMA therefore considers that undertakings in lieu of reference may in principle be available in this case.

104. The CMA therefore does not accept Abellio's submission that it should exercise its discretion not to refer because the monitoring costs of a possible undertaking in lieu would outweigh the benefits.
105. The CMA seeks to ensure in its consideration of any undertakings in lieu offered, that no remedy is disproportionate in relation to the SLC and its adverse effects.³⁵
106. For these reasons, the CMA does not believe that it is appropriate for it to exercise its discretion to apply the *de minimis* exception.

Decision

107. Consequently, the CMA believes that it is or may be the case that (i) arrangements are in progress or in contemplation which, if carried into effect, will result in the creation of a relevant merger situation; and (ii) the creation of that situation may be expected to result in an SLC within a market or markets in the United Kingdom.
108. The CMA therefore believes that it is under a duty to refer under section 33(1) of the Act. However, the duty to refer is not exercised whilst the CMA is considering whether to accept undertakings under section 73 of the Act instead of making such a reference.³⁶ The Parties have until 26 July 2019³⁷ to offer an undertaking to the CMA.³⁸ The CMA will refer the Franchise Award for a phase 2 investigation³⁹ if the Parties do not offer an undertaking by this date; if the Parties indicate before this date that they do not wish to offer an undertaking; or if the CMA decides⁴⁰ by 2 August 2019 that there are no reasonable grounds for believing that it might accept the undertaking offered by the Parties, or a modified version of it.

Joel Bamford
Senior Director, Mergers

³⁵ *Merger remedies*, para 3.6.

³⁶ Section 33(3)(b) of the Act.

³⁷ Section 73A(1) of the Act.

³⁸ Section 73(2) of the Act.

³⁹ Sections 33(1) and 34ZA(2) of the Act.

⁴⁰ Section 73A(2) of the Act.

