

# Anticipated acquisition by First Trenitalia West Coast Rail Limited of the West Coast Partnership Rail Franchise

## Decision on relevant merger situation and substantial lessening of competition

ME/6828-19

The CMA's decision on reference under section 33(1) of the Enterprise Act 2002 given on 7 November 2019. Full text of the decision published on 18 November 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 14 August 2019, the Department for Transport (**DfT**) announced that First Trenitalia West Coast Rail Limited (**FTWCRL**) was the successful bidder for the West Coast Partnership Franchise (**Franchise**). FTWCRL is a joint venture between entities ultimately owned by FirstGroup plc (**FirstGroup**) and Ferrovie dello Stato Italiane SpA (**FS Group**), respectively (together, the **Parties**).
2. The DfT and FTWCRL entered into a franchise agreement confirming the award of the Franchise to FTWCRL (the **Franchise Award**) on 28 August 2019 (the **Franchise Agreement**). The Franchise is due to commence on 8 December 2019. The operator of the Franchise is referred to as the **Franchisee** in this Decision.
3. The Franchise Award relates to the award of the Franchise to FTWCRL. The Franchise includes: (i) the existing InterCity services on the West Coast Mainline (**ICWC Services**), comprising long-distance intercity services between London, Birmingham, Manchester, Liverpool, North Wales, Glasgow and Edinburgh; (ii) the new shadow operator (**ShOp**) role to advise on the High Speed 2 (**HS2**)

project; and (iii) the Integrated Operator Contract (**IO Contract**) which governs the Franchise once HS2 is in operation.

4. The Franchise Award constitutes the acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. FTWCRL and the Franchise will therefore cease to be distinct.
5. The UK turnover of the 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.
6. The Franchise Award also meets the thresholds under Council Regulation (EC) 139/2004 (the **EC Merger Regulation**) for review by the European Commission (the **Commission**). The Parties submitted a reasoned submission to the Commission on 14 August 2019 requesting pre-notification referral to the CMA under Article 4(4) of the EC Merger Regulation. On 22 August 2019, 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 18 September 2019, the Commission announced its decision to refer the Franchise Award to the CMA for review.<sup>1</sup> The preliminary assessment period for consideration of the Franchise Award under section 34A(2) of the Act started on 19 September 2019. The statutory 45 working day deadline for a decision is 21 November 2019.
7. FirstGroup controls a train operating company (**TOC**) that currently offers public transport services on the TransPennine Express (**TPE**) franchise overlapping with the services provided by the Franchise. FirstGroup is the owner of two open access train operators, Hull Trains and East Coast Trains. First Group also operates a number of bus services which overlap with the services provided by the Franchise. In line with its Rail Franchise Mergers Guidance (**Rail Guidance**)<sup>2</sup>, 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 FirstGroup's existing rail and bus operations overlap with the rail services on the awarded franchise.

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<sup>1</sup> European Commission Decision: M.9407 – *First Trenitalia West Coast Rail/ West Coast Partnership Rail Franchise*, 19 September 2019.

<sup>2</sup> [Rail franchise mergers - Review of methodologies and guidance](#), CMA74, March 2018

8. The CMA considers that the ShOp role which relates to the Franchisee's role to provide consultation services on various elements of the HS2 project, does not involve the operation of public transport services. It therefore does not create any additional overlaps between the Parties in relation to public transport services. Nor does it confer any competitive advantage on the Parties in relation to the operation of existing or future public transport services. The CMA therefore believes that there is no realistic prospect of a significant lessening of competition (**SLC**) in relation to the ShOp element of the Franchise.
9. The CMA believes that the terms of the Franchise that govern the introduction and future operation of the High Speed Services (**HSS**) on the HS2 infrastructure, together with the reconfigured intercity services on the West Coast Mainline, are not sufficiently far advanced to assess with certainty whether FTWCRL will be the ultimate operator of the HSS, and to assess the competitive effects of that element of the Franchise as a possible relevant merger situation in itself.
10. The CMA has assessed the impact of the Franchise Award on the operation of public transport services, in relation to all flows where the ICWC Services overlap with those of FirstGroup, on the basis that they are:
  - (a) flows between the same two rail stations;
  - (b) flows between two rail stations which serve the same urban settlement; or
  - (c) flows where the origin/destination bus stop is not more than 800 metres from the origin/destination rail station.
11. The CMA reviewed the direct rail-rail overlaps between the Franchise and TPE. The CMA believes that the Franchise Award gives rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on 21 overlaps (listed in Annexes 1 and 2) which relate to flows on a continuous stretch of track between Preston and Edinburgh/Glasgow. In reaching this conclusion, the CMA found:
  - (a) on 17 flows there would be no other rail competitors;
  - (b) on four flows there would be very limited constraint from one other rail competitor;
  - (c) the Parties are close competitors on all 21 flows; and
  - (d) the Parties have both the ability and incentive to raise fares on all 21 flows.

12. The CMA reviewed ten direct bus-rail overlaps between the Franchise and First Group's bus services. The CMA believes that there is no realistic prospect of an SLC in relation to these ten bus-rail overlaps.
13. The CMA is therefore considering whether to accept undertakings under section 73 of the Act. The Parties have until 14 November 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

14. The predecessor West Coast Rail franchise generated revenue of £1,204 million in the year ending 31 March 2019.
15. FTWCRL is a joint venture between First Rail Holdings Limited and Trenitalia UK Limited (**TUKL**) which are ultimately owned by FirstGroup and FS Group,<sup>3</sup> respectively.
16. In the UK, FirstGroup currently operates the following rail franchises awarded by the DfT:
  - (a) the TPE franchise, operated by First TransPennine Express Limited;
  - (b) the Great Western rail franchise (**GWR**), operated by First Greater Western Limited trading as Great Western Railway;<sup>4</sup> and
  - (c) the South Western rail franchise (**SWR**), operated by First MTR South Western Trains Limited, a joint venture between FirstGroup and MTR Corporation.<sup>5</sup>
17. FirstGroup is also the owner of two open access train operators:

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<sup>3</sup> The latter by virtue of FS Group's ownership of Trenitalia SpA which owns TUKL.

<sup>4</sup> The Franchise Award does not create an overlap with the GWR franchise, which is, therefore, not considered further in this Decision.

<sup>5</sup> The Franchise Award does not create an overlap with the SWR franchise, which is, therefore, not considered further in this Decision.

- (a) Hull Trains Company Limited (**Hull Trains**), which operates services between Hull and London Kings Cross;<sup>6</sup> and
  - (b) East Coast Trains Limited (**East Coast Trains**), which is expected to commence services between London and Edinburgh in 2021.
18. In addition to the train services,<sup>7</sup> FirstGroup has three bus operating companies active in the provision of local bus services in the area covered by the Franchise:
- (a) First Glasgow (No.1) Limited) operating bus and coach services in the Glasgow area;
  - (b) First Glasgow (No.2) Limited) operating bus and coach services in the west central Scotland area;
  - (c) First Scotland East Limited operating bus and coach services in the east central Scotland.
19. In the UK, FS Group currently operates one rail franchise awarded by the DfT, the Essex Thameside (**ET**) franchise, operated by Trenitalia c2c Limited.<sup>8</sup>

## Transaction

20. Pursuant to the Franchise Award, FTWCRL will come to operate and control the Franchise.
21. The Franchise Agreement combines three distinct elements. These are:
- (a) The ICWC Services, ie the existing InterCity services on the West Coast Mainline which the Franchisee will be responsible for operating from 8 December 2019 until 1 April 2026;<sup>9</sup>

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<sup>6</sup> The Franchise Award will not create an overlap with Hull Trains, which is, therefore, not considered further in this Decision.

<sup>7</sup> FirstGroup also operates the Croydon Tramlink service on behalf of Transport for London. The Franchise Award does not create an overlap with this service, which is, therefore, not considered further in this Decision.

<sup>8</sup> The Franchise Award does not create an overlap with the ET franchise, which is, therefore, not considered further in this Decision.

<sup>9</sup> The CMA notes that, according to the Franchise Agreement, the Secretary of State can give notice to FTWCRL before the date on which the Franchise Agreement is due to expire that the Franchise Agreement shall continue after such date for such period as the Secretary of State may stipulate but not exceeding a period of approximately 3 years.

- (b) A new ShOp role for the Franchisee to provide consulting services and collaborate with the DfT and other stakeholders in order to design and plan for the launch of services on the HS2 infrastructure; and
  - (c) The IO Contract, which includes: (i) introducing and then operating High Speed Services from December 2026 or later<sup>10</sup> on Phase 1<sup>11</sup> and Phase 2a<sup>12</sup> of the HS2 infrastructure; and (ii) operating reconfigured and restructured ICWC operations on the existing West Coast Mainline network until the expiry of the Franchise Agreement.
22. In this Decision, the outgoing franchisee operating the current ICWC Services is referred to as **ICWC**.
23. FTWCRL's operation of the Franchise will commence on 8 December 2019.

## Procedure

24. The Franchise Award was considered at a Case Review Meeting.<sup>13</sup>

## Jurisdiction

25. The Franchise Award constitutes the acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. FTWCRL and the Franchise will therefore cease to be distinct.
26. The CMA considers that the ShOp element is one of the three main elements of the Franchise Award and, under the Franchise Agreement, the Franchisee is responsible for providing consultancy services on the design of HS2 as of the start of the Franchise. The CMA has therefore assessed the impact on competition of this element below.
27. The CMA notes that the third element of the Franchise Award, the IO Contract, is due to commence in December 2026 at the earliest. The CMA has therefore

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<sup>10</sup> In accordance with the Franchise Agreement, the Secretary of State may, from time to time, notify FTWCRL in writing of an amendment to the anticipated HSS start date, and/or anticipated HSS Established Services date, as defined in the Franchise Agreement. The CMA notes that the Written statement to Parliament "HS2 update: 3 September 2019" indicates the possibility of a delay to the schedule of 2026 for HSS: <https://www.gov.uk/government/speeches/hs2-update-3-september-2019>.

<sup>11</sup> From London to Birmingham (planned commencement in December 2026).

<sup>12</sup> From the West Midlands to Crewe (expected completion by December 2027).

<sup>13</sup> See *Mergers: Guidance on the CMA's jurisdiction and procedure* (CMA2), January 2014, from paragraph 7.34.

considered whether the IO Contract element falls within the scope of the present competitive assessment of the Franchise Award.

28. The Parties submitted that the IO Contract is structured as a management contract. The Parties submitted that it should therefore be assessed in a similar way to contracts governing the services of Crossrail and DLR. In particular, the Parties submitted that the CMA should follow the approach in *MTR/Crossrail*<sup>14</sup> and *KADL/DLR*,<sup>15</sup> in which the CMA found that it did not have jurisdiction to investigate those mergers. For example, in *MTR/Crossrail*, it was considered that Transport for London and its subsidiaries retained control over the commercial strategy, meaning that MTR did not have material influence over the operation of the Crossrail services.
29. The CMA notes that the previous cases cited by the Parties are underpinned by a different jurisdictional framework.<sup>16</sup> Consequently, the arguments relevant to a lack of control do not apply directly in this case. However, the CMA observes, based on the current version of the terms, the high degree of control currently to be exerted by the DfT over the IO Contract role, which would be relevant to the assessment of the IO Contract award.
30. The Parties additionally submitted that the Secretary of State for Transport (**Secretary of State**) has the power to terminate FTWCRL's award in relation to the IO Contract Period if FTWCRL fails the Readiness Review (discussed at paragraph 31 below).
31. The CMA notes that, in relation to the services under the IO Contract, the Franchise Agreement provides for several assessments such as the Annual Review, the Readiness Review scheduled for 2024 and the Switch Review. Under these review mechanisms, the Secretary of State will assess FTWCRL's ShOp performance and, under the Readiness Review in particular, whether FTWCRL's performance provides confidence in its ability to deliver HSS. Under the Franchise Agreement, the Secretary of State may terminate the Franchise Agreement under certain conditions.<sup>17</sup>

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<sup>14</sup> [MTR / Crossrail](#).

<sup>15</sup> [KADL / DLR](#).

<sup>16</sup> Section 66(3) of the Railways Act 1993 did not apply in either of [MTR / Crossrail](#) or [KADL / DLR](#), by virtue of the Railways (London Regional Transport (Exemptions) Order, SI 1994/573; see footnote 2 of each decision.

<sup>17</sup> Such as failure of the Readiness Review if the Franchisee does not meet the required performance scores under the Franchise Agreement.

32. The CMA also observes that one of the tasks of the ShOp is to advise HS2 and the Government in what form and under what conditions the HSS services should be provided. Accordingly, the Franchise Agreement's Schedule governing the IO Contract period is to a significant extent yet to be determined. In particular, the Franchise Agreement requires FTWCRL to obtain the Secretary of State's approval for the reports, strategies and plans (for example in relation to the customer experience, fares and marketing) which it would put forward in relation to the IO Contract. In relation to each of these outputs, it is envisaged that, once the Secretary of State is satisfied with a conclusion, it will incorporate provisions into the contractual terms and/or contracted business plans for the IO Contract period.<sup>18</sup>
33. The CMA therefore believes that the IO Contract element of the Franchise is not sufficiently far advanced to assess with certainty whether FTWCRL will be the ultimate operator of the HSS, the specific terms that would apply to that operator's activities, and to assess the competitive effects of the IO Contract element as a possible relevant merger situation in itself. Consequently, the CMA does not consider it appropriate to assess whether the IO Contract element would give rise to a duty to refer under section 33 of the Act. The CMA has therefore excluded this element of the Franchise from its assessment.
34. The UK turnover of the Franchise exceeds £70 million. Accordingly, the turnover test in section 23(1)(b) of 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.
35. As noted in paragraph 6, the Franchise Award meets the thresholds under the EC Merger Regulation for review by the Commission. FTWCRL submitted a reasoned submission to the Commission on 14 August 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 19 September 2019, the Commission announced its decision to refer the Franchise Award to the CMA for review.<sup>19</sup>

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<sup>18</sup> In the absence of agreement between the Secretary of State and FTWCRL, the Secretary of State would retain the ability to determine the terms governing the IO Contract.

<sup>19</sup> European Commission Decision: M.9407 – *First Trenitalia West Coast Rail / West Coast Partnership Rail Franchise*, 19 September 2019.



36. The initial period for consideration of the Merger under section 34ZA(2) of the Act started on 19 September 2019 and the statutory 45 working day deadline for a decision is therefore 21 November 2019.

## Counterfactual

37. The CMA assesses a merger's impact relative to the situation that would prevail absent the merger (ie the counterfactual). In accordance with the 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.<sup>20</sup> The CMA therefore treats the appropriate counterfactual as the award of the franchise to a TOC that raises no competition concerns.<sup>21</sup>
38. The Parties submitted that the Franchise Agreement makes clear that the Integrated Services, ie HSS and reconfigured ICWC Services in the IO Contract period, are an integral part of the Franchise and that therefore there is no scenario in which the HSS would be awarded to a different bidder to the ICWC Services. The Parties submitted that the relevant counterfactual therefore will not involve a situation with a greater degree of competition between the (reconfigured) ICWC Services and the HSS.
39. The Parties also submitted that the Franchise Agreement is clear that the Franchisee will be subject to a management contract during the IO Contract period with the DfT taking revenue and cost risk. Given these key features are determined and controlled by the DfT, the Parties submitted that there can be no realistic prospect of an SLC during the IO Contract period, regardless of how the ShOp role unfolds or how parts of the Franchise Agreement schedules are determined.
40. As part of their counterfactual arguments, the Parties also submitted that a number of events were highly likely to occur which would have a material impact on the Parties and on competitive conditions in relation to the overlap flows:
- (a) [✂];

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<sup>20</sup> Rail Guidance, para. 5.2.

<sup>21</sup> Rail Guidance, para. 5.4.

- (b) split ticketing<sup>22</sup> is becoming increasingly prevalent as new apps and websites allow customers to identify fare anomalies; and
- (c) expected policy changes: in July 2019, the Williams Report<sup>23</sup> identified simplified fares and ticketing as a key area of focus for reform, and the Parties said that the simplification of the number of fare types is widely expected to become government policy. In the light of these likely policy changes, the Parties submitted that the removal of fare types or a reduction in the availability of certain fare types cannot automatically be viewed by the CMA as a detriment to consumers.
41. As stated at paragraphs 31-33 above, the CMA believes that there is considerable uncertainty around the provision of the Integrated Services under the IO Contract element of the Franchise and the CMA has excluded this element of the Franchise from its assessment. The CMA therefore has not had to decide on the relevant counterfactual with regard to the IO Contract element of the Franchise Award.
42. As to the ICWC Services and the ShOp element, in accordance with the CMA's Rail Guidance, the CMA will treat the appropriate counterfactual as the award of the Franchise to a firm that raises no competition concerns.<sup>24</sup> As discussed further below, there are plans to expand a number of rail services, such that the characteristics of some services (eg the frequency of some services) are likely to change in the future. The CMA considered the implications of these expansions (and whether they would have taken place in the counterfactual) as part of its competitive assessment (see further 'Expansion flows').
43. The possibility of the events listed in paragraph 40 above occurring is unrelated to the identity of the Franchisee and the Parties have not provided compelling evidence that the CMA should apply a counterfactual other than the award of the franchise to a TOC that raises no competition concerns. Accordingly, these events will be assessed in the competitive assessment below, to the extent relevant.<sup>25</sup>

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<sup>22</sup> 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.

<sup>23</sup> Williams Rail Review: an update on progress, 16 July 2019: <https://www.gov.uk/government/speeches/williams-rail-review-an-update-on-progress>.

<sup>24</sup> Rail Guidance, paragraph 5.4.

<sup>25</sup> *Merger Assessment Guidelines*, footnote 39.

## Frame of reference

44. 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.<sup>26</sup>
45. FirstGroup operates and/or will operate public transport services that overlap with the areas covered by the ICWC Services part of the Franchise.
- (a) There are a number of overlapping rail ‘flows’ ie travel between a specific point of origin and a specific point of destination<sup>27</sup> between the ICWC Services and FirstGroup’s TPE franchise. These overlaps principally relate to the area between Preston and Glasgow/Edinburgh. The TPE franchise will expire in April 2023 (subject to extension by the DfT for up to two years).
- (b) FirstGroup has plans to launch an open access rail service (East Coast Trains) between London and Edinburgh, which creates a single overlap with the ICWC Services between London and Edinburgh.
- (c) There are 10 local bus services currently operated by FirstGroup that overlap with rail services operated by the Franchise.

## Product scope

### *Competition for the market*

46. In line with previous decisional practice, most recently *Abellio / East Midlands*,<sup>28</sup> *First MTR / South Western*<sup>29</sup> and *Arriva / Northern*,<sup>30</sup> the CMA considers that the relevant frame of reference for competition for the market is the award of rail franchises.

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<sup>26</sup> [Merger Assessment Guidelines](#), paragraph 5.2.2.

<sup>27</sup> [Rail Guidance](#), paragraph 3.3.

<sup>28</sup> [Abellio / East Midlands](#), paragraph 25.

<sup>29</sup> [First MTR / South Western](#), paragraph 24.

<sup>30</sup> [Arriva / Northern](#), Final report of 2 November 2016, paragraphs 6.4-6.7.

### *Competition in the market*

47. 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 and the CMA has considered the possible constraint from other modes of transport where relevant in the competitive assessment.<sup>31</sup> Although the Parties submitted that private cars were an effective substitute on many of the overlapping rail flows, the Parties have not opposed the approach described in the Rail Guidance.
48. The CMA has not received any evidence to suggest that a departure from its Rail Guidance would be appropriate in the present case. 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*

49. 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*

50. 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 as the geographic frame of reference the flow on which the Parties' existing rail and bus operations overlap with the rail services on the awarded franchise.<sup>32</sup>

#### *Rail-rail overlaps*

51. The CMA generally defines overlapping rail-rail flows as rail services between the same two rail stations or the same two settlements.<sup>33</sup>

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<sup>31</sup> Rail Guidance, paragraph 4.5.

<sup>32</sup> Rail Guidance, paragraph 3.3.

<sup>33</sup> Rail Guidance, paragraph 4.8.

52. The CMA has not received any evidence to suggest that a departure from its guidance would be appropriate in the present case.
53. 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. 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 or the quality of rolling stock. However, this is taken into account where relevant in the competitive assessment.
54. 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 references to a flow from A to B also include the reverse journey.
55. In accordance with the Rail Guidance,<sup>34</sup> the CMA may consider whether two different stations on different lines could constitute alternatives for passengers. In instances where a town or city has more than one station which passengers may use, the stations are combined into one 'settlement'.
56. The CMA has therefore considered the impact of the Franchise Award on all flows that overlap with the ICWC 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.
57. The CMA has treated Edinburgh Waverley and Edinburgh Haymarket as both serving the same settlement, Edinburgh, in line with its Rail Guidance<sup>35</sup> and the approach taken in previous cases.<sup>36</sup>

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<sup>34</sup> Rail Guidance, paragraph 4.8.

<sup>35</sup> Rail Guidance, paragraph 4.8.

<sup>36</sup> For example, *First MTR / South Western*. In addition, the CMA notes that, in this case, the competitive assessment of treating these two stations as separate points would not lead to a materially different outcome.

### *Bus-rail overlaps*

58. The CMA generally defines overlapping bus-rail flows as bus and rail services where the catchment area of a rail service contains bus stops.<sup>37</sup> In accordance with the CMA's Rail Guidance, in identifying overlaps between First Group's bus services and the Franchise, the CMA has assessed the catchment area on the basis of a walking distance of 800 metres centred on the rail station.<sup>38</sup>

### **Conclusion on frame of reference**

59. 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 ICWC Services, on the basis that they are:
- (a) flows between the same two rail stations;
  - (b) flows between two rail stations which serve the same settlement; or
  - (c) flows where the origin/destination bus stop is not more than 800 metres from the origin/destination rail station.

## **Competitive assessment**

### ***Competition for the market***

60. 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 the Parties with an incumbency advantage relative to other bidders in future bids for franchises.
61. The CMA considers that the award of the Franchise will have no meaningful impact on competition for the award of future franchises, on the basis that:
- (a) the award of the Franchise to FTWCRL would not reduce the number of bidders for future franchises;

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<sup>37</sup> Rail Guidance, paragraph 4.8.

<sup>38</sup> Rail Guidance, paragraph 4.10.

- (b) the Parties would not obtain incumbency advantages for future franchises through the acquisition of the Franchise; and
  - (c) the combined share of franchises the Parties already hold and the increment obtained through the award of the Franchise are moderate, with the Parties estimating a combined post-award share of [30-40]% for the franchises wholly or partly controlled by FirstGroup, with an increment of [10-20]%, and a combined post-award share of [10-20]% for the franchises wholly or partly controlled by Trenitalia.
62. In addition, 13 different TOCs currently hold UK rail franchises.<sup>39</sup> 18 different TOCs currently hold pre-qualification questionnaire 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 six franchise competitions.<sup>40</sup> Therefore, the CMA does not consider that the award of this Franchise to the Parties 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.
63. 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*

64. 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.<sup>41</sup> Horizontal unilateral effects are more likely when the merger parties are close competitors.

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<sup>39</sup> Abellio, First Group, Arriva, Go-Ahead, Stagecoach, Keolis, Virgin, MTR, Mitsui/JRE, Trenitalia, Serco and Amey, UK Government.

<sup>40</sup> Including the East Midlands, South Eastern, West Coast Partnership, South Western, West Midlands, and Wales and Borders.

<sup>41</sup> [Merger Assessment Guidelines](#), paragraph 5.4.1.

65. The CMA assessed whether it is or may be the case that the Franchise Award may be expected to result, in an SLC in relation to unilateral horizontal effects in relation to the ShOp element of the Franchise and the rail-rail and bus-rail overlaps referred to in paragraph 45 above. The CMA's analysis is set out below.

*The ShOp element of the Franchise*

66. As part of the Franchise, and in preparation for the operation of the HSS and Integrated Services, the Franchise Agreement provides for the ShOp role to be performed by the Franchisee in advance of HSS being established.
67. The CMA considers that the ShOp role does not involve the operation of public transport services and therefore does not create any additional overlaps between the Parties in relation to public transport services; nor does it confer any competitive advantage on the Parties in relation to the operation of existing or future public transport services. The CMA therefore believes that the ShOp element of the Franchise will not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in respect of any flow.

*Rail-rail overlaps*

68. The concern under this theory of harm is that the common ownership of overlapping rail services could give the Parties 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.<sup>42</sup> This is on the basis that, after the Franchise Award, it would be less costly for the Parties to raise prices (or lower quality) because they would recoup profit on recaptured sales from customers who would have switched to the overlapping rail service.
69. 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, franchise contracts generally restrict the ability of the TOC to adjust service quality significantly.<sup>43</sup> Additionally, in most cases it is

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<sup>42</sup> 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 Advance ticket) altogether where available.

<sup>43</sup> In *Arriva / Northern*, the CMA analysed parts of the Franchise Agreement and found that, because of the strongly regulated quality, a service quality-related theory of harm was unlikely (see paragraphs 8.35-8.50).



difficult to vary quality on an individual flow without affecting the entire route, and most rail-rail overlaps, including those relevant in this case, only take up a subset of the route. Therefore, the incentive to vary quality is reduced. In the present case, the Parties submitted that a combination of measures in the Franchise Agreement creates a strong incentive for the Parties to avoid degradation of service or quality and to grow revenues in line with its franchise financial model as they are on cost and revenue risk. These include the Parties' financial, as well as funding and performance related obligations.<sup>44</sup> Therefore, the CMA believes that the Parties would not have the ability or incentive to adjust service quality and the CMA's assessment below focuses on fare-related theories of harm, in relation to the following types of fare:

- (a) dedicated tickets or fares: a dedicated fare is valid for travel on a specific TOC's services. They are unregulated as to price or number of tickets released, both of which are determined by the relevant TOC;<sup>45</sup>
- (b) inter-available tickets or fares: these tickets are valid for travel on any franchise operating on the flow and the associated revenues are divided between the franchisees in fixed proportions rather than actual passenger journeys. On each flow one franchisee is the designated fare setter for the inter-available tickets on the flow.<sup>46</sup>

70. Any loss of competition on an individual flow could be realised in a number of different ways. First, on all of the flows considered in detail below, at least one of the Parties has a dedicated fare. One common reason for dedicated fares is to compete to attract passengers away from inter-available tickets: a TOC receives 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. A TOC can also use dedicated fares to attract passengers to its services in competition with the dedicated fares offered by other TOCs. Consequently, the

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<sup>44</sup> The Parties submitted that they have joint responsibility for provision of the performance bond, season ticket bond and funding deed commitments for the first period of the Franchise, ie when the Franchise will operate the ICWC Services and perform its ShOp role. The Franchise Award also includes a formal annual review regime (see paragraph 31 above). Performance at these reviews can lead to a range of remedial processes, including a potential Event of Default and consequences for the amount of ShOp performance fees. Poor scores may result in a failure of a Readiness Review, with the potential for the Franchise Agreement to be terminated without proceeding to the IO Contract stage.

<sup>45</sup> Dedicated fares can be either advance or walk-up. For advance tickets, a certain volume of tickets is 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.

<sup>46</sup> There are also routed inter-available fares where the ticket can be used on any TOC following a specific route (eg via a specific intermediary station).

CMA considers that ICWC's dedicated fares are currently set to compete with TPE and vice versa.

71. The CMA's first concern is therefore that FirstGroup may have an ability and incentive either to increase the dedicated fare(s) of TPE and/or the Franchise, to remove the dedicated fare(s) and/or to reduce the number of dedicated fare tickets available as a result of any loss of competition following the award of the Franchise.
72. Second, inter-available fares are available on each flow. Since dedicated fares are intended to attract passengers to the services of a specific TOC, dedicated fares may therefore constrain the inter-available fare on a flow.<sup>47</sup> Therefore, following the start of the Franchise, the Parties may have the ability and incentive to increase inter-available fares on flows where one of the Parties is the fare setter. On flows where a third-party TOC is the fare setter, any loss of competition between the Parties with respect to dedicated fares could also reduce the competitive constraint on the fare setter's inter-available fares, leading the fare setter to set a higher inter-available fare.

#### *Framework for assessment*

73. 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 Franchise overlaps with FirstGroup's existing TPE rail operations.
74. There are 41 rail-rail overlaps between the Franchise and FirstGroup's TPE services, treating Edinburgh Waverley and Edinburgh Haymarket separately. The CMA undertook the filtering methodology described in its Rail Guidance<sup>48</sup> to exclude overlapping flows on which an SLC is least likely.<sup>49</sup> While the filters are not intended to provide a complete decision rule, the CMA found no evidence (such as internal documents or comments from third parties) to suggest that competition concerns may arise on flows that were excluded by the filters,<sup>50</sup> other than the Wigan North Western – Preston and Motherwell – Carlisle flows as

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<sup>47</sup> As discussed further below, an exception is likely to arise where the fare setter for the inter-available fare does not have a financial interest in the flow and therefore does not set the inter-available fare to maximise profits.

<sup>48</sup> Rail Guidance, section 6.

<sup>49</sup> All but one of the excluded flows were excluded from further analysis based on the small flows filter. The exception is Glasgow – Motherwell, which is filtered out not by the small flows filter, but by the effective competitor filter.

<sup>50</sup> Rail Guidance, paragraph 6.3.

discussed further below. Accordingly, for the rail-rail overlaps excluded by the filtering exercise, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects. Following the application of these filters, when treating Edinburgh Waverley and Edinburgh Haymarket as a single settlement in line with the Rail Guidance, and adjusting the use of these filters to take into account possible future expansion, the CMA identified 24 rail-rail overlaps for further analysis.<sup>51</sup> All of the rail flows, except for the Manchester – Stockport flow, are on a continuous stretch of track between Wigan North Western and Glasgow or Edinburgh. For most of these rail flows, FTWCRL and TPE will be the only two TOCs offering rail services post-Franchise award.<sup>52</sup>

75. In undertaking its assessment, the CMA has grouped the remaining rail flows as summarised below:

- (a) Flows on which the Parties are the only TOCs offering train services.<sup>53</sup> These 17 flows are listed in Annex 1.
- (b) Flows on which there is one competing TOC other than the Parties.<sup>54</sup> These four flows are listed in Annex 2.
- (c) Expansion flows. These are the Wigan North Western – Preston and Motherwell – Carlisle flows, listed in Annex 3, that are currently excluded by the small flows filter but may not be excluded in the future because of plans to expand the number of services on those flows.

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<sup>51</sup> The Parties identified 26 of the original 41 flows for further analysis after filtering. The CMA included two additional flows on the basis of possible future expansion (Wigan North Western – Preston and Carlisle - Motherwell) and one additional flow (Glasgow – Lockerbie) which the Parties had initially excluded on the basis of the implausible flows filter. This left 29 flows of which ten flows involving Edinburgh Haymarket and Edinburgh Waverly were combined, due to treating Edinburgh as a single settlement, leaving 24 flows.

<sup>52</sup> The CMA notes that there is a sleeper service (Caledonian Sleeper) on some of the relevant flows. However, sleeper services are limited to very particular times of day and only run one or two services per day. Therefore, this statement applies for day time services. For this reason, when describing whether FTWCRL and TPE face competition from another TOC on a flow, the CMA is not considering the sleeper service as a competing TOC. Therefore, the CMA has not distinguished between the flows where the sleeper service is active and those where it is not. This is consistent with the CMA's findings in the previous cases regarding the competitive constraint from the sleeper service (eg *Inter City Railways Limited / ICEC Franchise*, paragraph 78).

<sup>53</sup> As noted, the sleeper service is active on some of these flows but is not considered as a competing TOC for the reasons previously provided. This category also includes the Carlisle – Preston and Carlisle – Lancaster flows where Northern is also active but the Northern service travels via the Cumbrian coast with a travel time almost two hours longer than the ICWC and TPE travel times. As such the CMA does not consider these Northern services to be plausible alternatives for passengers. This is consistent with the negligible revenues attributed to Northern on these flows.

<sup>54</sup> As described above, this categorisation does not include the sleeper service.

(d) The Manchester Piccadilly to Stockport flow.

76. The following sections present the CMA's assessment of the 24 flows using the groupings described in paragraph 75 above.
77. In addition, the CMA has also assessed the single overlap between the East Coast Trains open access rail service which is expected to commence on the London – Edinburgh route via the East Coast Mainline in 2021 and the ICWC Services on London – Edinburgh via the West Coast Mainline.

*Flows on which the Parties are the only TOCs offering train services*

78. Following the Franchise Award, on the 17 flows listed in Annex 1, the Parties will operate 100% of passenger rail services with no other TOC offering a competing service. Further, the increment to the Parties' share of rail services on these flows is substantial:<sup>55</sup> on average [30-40]% by revenue and on average [30-40]% by number of trains and no less than [10-20]% by revenue and [20-30]% by number of trains.<sup>56</sup>
79. The CMA notes that on all of the flows except one<sup>57</sup> either ICWC or TPE is a fare setter for inter-available fares, while both Parties have dedicated fares.
80. Regulated fares account for only a small proportion of revenues on most of these flows and no more than [50-60]%,<sup>58</sup> while dedicated fares account for a substantial proportion, with an average of more than [60-70]% and no less than [10-20]%.<sup>59</sup>

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<sup>55</sup> The CMA notes that on most flows the increment of the Party having the lower market share is at least [40-50]%. Four flows have an increment of less than [20-30]% but on all of these flows there are no competing TOCs (other than the sleeper service previously discussed).

<sup>56</sup> In relation to the Glasgow – Lockerbie flow, which has the lowest increment with [10-20]% by revenue, the CMA's current view is that this increment is substantial given the lack of competing TOCs on this flow.

<sup>57</sup> The exception is Carlisle – Penrith flow (fare setter Cross Country). Edinburgh – Preston, Glasgow – Preston, Lancaster to Carlisle and Preston to Carlisle have more than one fare setting TOC (since there are routed inter-available fares), but on each of these flows at least one of the Parties is the fare setter for the most commonly used inter-available fares.

<sup>58</sup> For ICWC on average [5-10]% and at most [50-60]% (Penrith – Lancaster) and for TPE, on average [0-5]% and at most [10-20]% (Carlisle – Penrith)

<sup>59</sup> For ICWC on average [60-70]% and at least [10-20]% (Penrith – Lancaster) and for TPE on average [60-70]% and at least [40-50]% (Carlisle – Lancaster and Penrith – Lancaster).

### *Closeness of competition*

81. As shown in Annex 1, the CMA considers that services on ICWC and TPE have very similar characteristics as regards journey times<sup>60</sup> and broadly similar frequencies.<sup>61</sup> The similarities in journey times and travel costs are reflected in the Generalised Journey Cost (**GJC**)<sup>62</sup> analysis provided by the Parties.<sup>63</sup>
82. The decision of ICWC and TPE to offer dedicated fares already on each of these flows is consistent with the TOCs being close competitors to serve passengers on these flows, since one of the reasons for offering such fares is to compete with the dedicated fares offered by other TOCs and to attract customers away from inter-available fares.
83. The Parties submitted generally that there are substantial differences in the frequency of train departures between ICWC and TPE and that therefore the Parties are not close competitors. The Parties also submitted that the GJC analysis of ICWC and TPE significantly overstates the closeness of competition between those services, as the waiting time in GJC is capped at 7.5 minutes. The Parties submitted that if this waiting time cap were to be removed, six flows<sup>64</sup> would have a GJC differential greater than 25%.
84. The CMA notes that passenger train services are a relatively homogenous service and that the Parties are the only passenger service providers on these flows with no competing TOCs present post-Franchise Award. The CMA therefore considers that, in this context, a difference in frequency of trains between TPE and ICWC is unlikely to mean that the two are not currently close competitors. Moreover, both Parties offer more than 70 departures per week on most flows, ie on average ten trains per day, with only five flows offering weekly services of 50 services or fewer.

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<sup>60</sup> The biggest difference in journey times is less than 20 minutes for a journey of over two hours (Glasgow-Preston). In most cases the difference is only a few minutes.

<sup>61</sup> On almost all flows (except Glasgow – Lockerbie) both ICWC and TPE offer multiple services throughout the day.

<sup>62</sup> The GJC provides a weighting of the different mode characteristics, including fares, journey time and frequency, based on econometric estimates of customers' preferences. If the GJCs of the overlapping services are very different, this will suggest that the services do not compete closely. See paragraph 7.20 of the Rail Guidance.

<sup>63</sup> This analysis shows that, for each of the flows, the GJC for ICWC and TPE is below the 25% threshold at which the CMA would be unlikely to find a competition problem ([Rail Guidance](#), paragraph 7.45). This finding is consistent across the different assumptions that could be made to calculate the GJC, based on the Parties' submissions.

<sup>64</sup> Edinburgh (Waverly) – Penrith, Edinburgh (Haymarket) – Preston, Edinburgh (Haymarket) – Oxenholme, Carlisle – Preston, Carlisle – Oxenholme and Lancaster – Penrith.

85. Regarding the Parties' submission that the CMA should adjust the GJC model in respect of the waiting time cap, the CMA's view is that it would be inappropriate to do so. This is because a substantial number of customers are unlikely to arrive at the station<sup>65</sup> and board the first available train, particularly for longer flows (with more expensive fares)<sup>66</sup> where customers usually plan their journey in advance. Therefore, passengers may well view services as close alternatives despite the differences in frequencies.
86. Even with regard to the flow with the fewest train departures (Glasgow – Lockerbie), ICWC offers 37 services per week against 109 services from TPE, ie a daily average of five departures versus 15 departures. The Parties submitted that the timings of ICWC's Glasgow – Lockerbie services meant that ICWC and TPE were not close competitors on this flow. The CMA acknowledges that passengers seeking to travel on this flow during the middle of the day are unlikely to consider ICWC services, since ICWC trains only alight in Lockerbie during the early morning and evening hours.<sup>67</sup> However, passengers seeking to travel from Lockerbie to Glasgow for work in the morning and from Glasgow to Lockerbie in the evening after work (or vice versa) are likely to consider the Parties' services as close alternatives.
87. The evidence provided to the CMA is consistent with a significant number of passengers travelling on these morning and evening services, for example the revenue for ICWC's services (which mainly operate at these times) is around £ [X], which is well in excess of the small flows filter in the CMA's Rail Guidance. Both ICWC and TPE also offer dedicated fares on this flow which account for a substantial proportion of revenue on this flow. The decision of ICWC and TPE to introduce these fares is consistent with close competition between the TOCs on this flow prior to the Franchise Award. Therefore, the CMA believes that there is close competition between the ICWC and TPE services for passengers who travel on this flow during early morning and evening hours, at a minimum.
88. Consistent with the CMA's assessment, a third party that responded to the CMA's investigation expressed the view that the current rail services offered by ICWC and TPE on the flows between Preston and Carlisle are similar in terms of

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<sup>65</sup> This is consistent with the existence of advance fares on these flows which can only be purchased in advance.

<sup>66</sup> The travel time of the majority of the flows is one hour or longer and only one flow has a travel time of less than 30 mins.

<sup>67</sup> During weekdays in the morning, the 07:11-08:19 TPE service and 08:11-09:18 ICWC service are the only trains arriving before 10:30. In the evening, TPE has a 17:08 and 19:08 service while ICWC has a 17:40 service.

journey duration, fares, frequencies and times of operation (noting, however, that the services differ in quality).

89. For the reasons set out above, the CMA therefore believes that the Parties' rail services are close competitors in relation to each of the flows at Annex 1.

- *Ability to increase fares*

90. As described in the Rail Guidance, the CMA considers that a TOC has the ability to increase unregulated fares if there is headroom relative to other, especially regulated fares on a flow.<sup>68</sup> The CMA considers that there is sufficient headroom for the Parties to implement price increases on each flow listed in Annex 1 post-Franchise Award. The CMA's calculations indicate that on each of these flows there is headroom of at least £[redacted],<sup>69</sup> and on many flows the headroom is considerably higher.<sup>70</sup> This indicates that the Parties have the ability to increase fares.

91. The Parties submitted that they do not have a meaningful ability to increase unregulated fares because:

(a) FTWCRL is operated by a JV between FirstGroup and TUKL. FirstGroup said that the relationship between the JV partners was important, and that [redacted]. Therefore, the Parties would not increase fares;

(b) their ability to raise fares on the flows would be constrained by the Parties' aim for a simple, coherent, logical and consistent fare structure;

(c) TPE is [redacted];

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<sup>68</sup> Rail Guidance, para 7.29. As para. 7.28 of the Rail Guidance describes, the CMA will also consider whether an unregulated, but less restricted ticket might also provide a price ceiling, although the CMA will also consider whether that fare might also be increased following the merger.

<sup>69</sup> The evidence is also consistent with there being material headroom on the Glasgow-Lockerbie flow where competition between ICWC and TPE may be limited to certain times of day. In particular, there is material headroom in relation to the ICWC services on this flow.

<sup>70</sup> The CMA's base case approach to calculating headroom for walk-up fares takes the lowest headroom with respect to a regulated ticket on the same flow. Where the inter-available fare is set by a public authority or by a TOC that does not operate on the flow, that fare is used as a benchmark as well, since these inter-available fares are less likely to be constrained by dedicated fares. Any constraint from travelling short, as well as a hypothetical 30% cap on the price increase of any particular fare (cf. Rail Guidance, fn. 144) are only taken into account when assessing the Parties' incentive to increase fares. For advance fares, the CMA has taken the approach more generous to the Parties, without taking into account that the price of the comparator fare could itself be increased following the Franchise Award. There is also no regulated equivalent for many of the fares offered by the Parties, eg first class fares, such that it is not possible to formally calculate a headroom for these fares.

(d) in the light of the policy changes following the Williams Report, the removal of fare types or a reduction in the availability of certain fare types cannot automatically be viewed by the CMA as a detriment to consumers.

92. First, as regards the Parties' ability to increase prices, the CMA considers that the risk of fare increases identified is unlikely to be removed by the fact that FTWCRL is operated as a JV. This is because the CMA's concerns on these flows, when taken together, would benefit both JV partners, and it is unlikely that TUKL would object to a set of fare changes that would make FTWCRL more profitable. In any case, the CMA notes that FirstGroup confirmed during the Issues Meeting [REDACTED]. The CMA found in *First MTR / South Western* that the latter JV arrangements did not materially affect the Parties' ability to raise fares.<sup>71</sup> Consistent with that decision, the CMA considers that the JV arrangements between FirstGroup and TUKL will also not materially affect the Parties' ability to raise fares with regard to the flows discussed in this Decision for the same reasons.
93. Second, as regards the necessity of a coherent pricing structure which would prevent any competition concerns, the CMA notes that the 17 flows in this category are on a continuous stretch of track and are flows where the Parties are the only TOCs. The CMA considers that the Parties would be able to implement various fare price increases across the whole stretch of track<sup>72</sup> and at the same time have one coherent pricing structure.<sup>73</sup> The Parties have also not submitted any evidence showing how the need for a coherent pricing structure would materially limit their ability to increase fares and the CMA considers that there is sufficient headroom on all of the 17 flows.
94. Third, in relation to the [REDACTED], the Parties submitted insufficient information to substantiate the likelihood of any significant changes to [REDACTED]. The CMA has also not received sufficient evidence to indicate that [REDACTED].
95. Finally, the Parties did not substantiate how the simplification of the fare system would impede their ability to raise fare prices or to reduce the availability of

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<sup>71</sup> *First MTR / South Western*, paragraphs 71-74.

<sup>72</sup> This also implies that any costs associated with a price increase can be spread across all of the flows concerned.

<sup>73</sup> As described below, the CMA's current view is that the presence of another competing TOC on some of the flows on the same continuous stretch of track (ie the four flows described in paragraph 75(b) and further in paragraphs 121 to 142, and which lie on the same stretch of track as the 17 flows discussed in this section) will not be sufficient to prevent competition concerns from arising on those flows.



certain types of dedicated fares. Further, the changes that may arise as a result of the Williams Report are as yet unclear.

- *Incentive to increase fares*

96. In assessing the incentive to increase fares, the Rail Guidance describes how the CMA considers the closeness of competition between the overlapping TOCs, the competition the overlapping TOCs face from other TOCs on the same flow, and any evidence of adjustment costs.<sup>74</sup>
97. In its assessment, the CMA considered a range of sensitivities to incorporate different levels of price increase and customer substitution. Having done so, the CMA still considered that FTWCRL and TPE would materially benefit from increasing fares on the affected flows such that there would be an incentive to do so. The CMA considers this is especially the case since prices and the number of advance tickets available are regularly adjusted, and the implementation costs of increasing prices are minimal. The Parties did not dispute that the direct administrative costs of such adjustments are low. Furthermore, in this case, significant competition concerns are likely to arise in relation to a continuous stretch of track such that adjustments could be made across this stretch of track simultaneously.
98. The Parties submitted that they would not have the incentive to increase fares because:
- (a) passengers are leisure customers whose demand is particularly elastic;
  - (b) the Parties are competitively constrained by other modes of transport, such as cars;
  - (c) the possibility of 'split ticketing' and 'travelling short'<sup>75</sup> constrained their fares on these flows;
  - (d) a proportion of revenue on these flows will come from inter-available fares set by third-party operators;

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<sup>74</sup> Rail Guidance, para 7.30 - 7.48.

<sup>75</sup> 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.

- (e) the [X] will be FirstGroup's major focus and it would, therefore, not want to further [X] increasing fares.
  - (f) there will be a limited overlap period between the TPE franchise and the Franchise of only three years (subject to the possibility of TPE's extension in April 2023), with the DfT exercising increased oversight over changes in TPE pricing in the final year of that franchise which will also cover the expansion period;
  - (g) the overlaps are minimal and the affected flows account for a small proportion of total revenue;
99. Many of these submissions are general and apply across most or all flows and are considered in turn below. Where relevant, the CMA assessed the specific circumstances of individual flows.
100. First, regarding the submission that passengers may have particularly elastic demand because they are leisure passengers, the relevant consideration for the CMA's assessment is an understanding of where passengers may switch to in response to an increase in price by ICWC or TPE. In this context, demand may be elastic for an individual TOC in part because of competition from other TOCs on the same flow. The CMA has considered, based on the evidence provided, whether this is likely to be the case in its competitive assessment. As set out below, the CMA's view is that the constraint from alternative means of transport or from passengers not travelling at all are not enough to prevent an SLC on any of the 17 overlap flows given the closeness of competition between the ICWC and TPE rail services.
101. Second, as regards the constraints from other modes of transport such as cars, the Parties submitted that journey times by private car are broadly comparable to those by rail, that the travel cost for private car travel can be lower and that substitutability between car travel and that rail travel is illustrated by internal documents.
102. As stated in the Rail Guidance, to assess the constraint imposed on public transport by private transport, the CMA generally looks for evidence of passenger switching from public transport to private transport in response to a small change in the offerings (eg fares and service quality).<sup>76</sup> The Parties did not provide

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<sup>76</sup> Rail Guidance, paragraph 4.6.

evidence specific to the flows being considered. Whilst the CMA acknowledges that, in the event of a price increase, some rail passengers may switch to other modes of transport including private cars, private car travel is unlikely to be a suitable option or a close alternative for a substantial proportion of current rail passengers.<sup>77</sup> This finding is consistent with the evidence provided by the Parties. For example, the Parties refer to a diversion ratio of [30-40]% from rail to private car in non-London inter-urban journeys. This implies very substantial diversion to remaining rail services and on all of these flows the Parties will be the only remaining train service providers. Therefore, the CMA considers that the competing rail services are likely to be far closer alternatives to each other for existing rail passengers than travelling by private car.<sup>78</sup> Accordingly, the CMA considers it is unlikely that any constraint from private cars will be sufficient to offset the effects of the Merger.

103. Third, in relation to the Parties' submission that they would not be able to increase prices because an increasing number of customers would either use split ticketing or would travel short, the CMA believes that travelling short and/or split ticketing does not impose a sufficient constraint on the Parties' fares on these flows to prevent significant competition concerns from arising for the reasons set out below.
- (a) Split ticketing is unlikely to be a significant constraint where the alternative flow is also affected by any loss of competition as a result of the Franchise Award and/or where one of the overlapping TOCs operates on the flow. This applies in this case since the flows on which split ticketing could be used are on the same continuous stretch of track on which both FTWCRL and TPE operate.
  - (b) As regards travelling short, the Parties identified for all of the flows a number of routes on which a passenger could travel short using a third party fare setter (eg Northern Trains). However, some of the travelling short options identified by the Parties provide evidence that travelling short is not a significant constraint on the Parties' ability to raise fares. For example, the Parties identified a Northern Trains Anytime Return from [X] and [X] as a travelling short alternative to ICWC's [X] Anytime Return. However, the

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<sup>77</sup> For example, passengers who do not have access to a private car.

<sup>78</sup> The CMA considers that the same observation applies to the Parties' submission that passengers may decide not to travel at all.

price of the ICWC ticket is currently £[X] compared to the Northern Trains price of £[X]. The current higher price for the ICWC service is not consistent with travelling short using such alternatives being a significant constraint on the Parties' incentive to increase fares.<sup>79</sup>

- (c) More generally, the Parties have not presented sufficient evidence showing that split ticketing and/or travelling short are common in practice or that they would constrain the Parties' behaviour. In particular, the Parties have not demonstrated that a material number of passengers would be likely to use split ticketing or travelling short on these flows in response to a fare increase (such as to remove the risk of the Parties having an incentive to raise prices post-Franchise Award). For example, the Parties did not provide internal documents substantiating their submissions. Even if these constraints may limit the incentive to increase fares, they do not remove it completely, as discussed above.

104. Fourth, regarding the constraint from inter-available fares, the CMA notes that either ICWC or TPE are the fare setter for all flows in Annex 1 except one (Carlisle – Penrith). Therefore, where ICWC or TPE is the fare setter this argument does not apply.

105. In relation to the Carlisle – Penrith flow, Cross Country is currently the fare setter but Cross Country is not active on the flow. Since Cross Country does not compete with the Parties on this flow, the CMA considers it unlikely that the inter-available fare on this flow is currently constrained by the FTWCRL and TPE dedicated fares or that Cross Country would increase the inter-available fare in response to any loss of competition between FTWCRL and TPE. As such, Cross Country's inter-available fare could in principle constrain the ability of the FTWCRL and TPE to increase fares on this flow. However, the CMA considers that:

- (a) there is sufficient headroom to the inter-available fare on Carlisle – Penrith such that FTWCRL and TPE have the ability to increase fares on this flow; and

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<sup>79</sup> Other examples include anytime return [X] (with an alternative ticket to [X]), where the longer alternative costs £[X], compared to £[X] on ICWC and [X] (with an alternative ticket to [X]), where the longer alternative costs £[X], compared to £[X] on TPE.

(b) this consideration only applies while Cross Country sets the inter-available fare and is not active on the flow. The CMA understands that the fare setter (ie the lead operator) can be changed following a request to the current fare setter and after all TOCs operating on the flow have consented to this change.<sup>80</sup> The CMA considers that Cross Country would be unlikely to object to any such request given that it is not active on this flow and, since FTWCRL and TPE would be the only active TOCs on this flow, no other TOCs would object either.

106. Accordingly, the CMA considers that FTWCRL and TPE have the ability and incentive to raise dedicated fares on this flow. Given the relative ease with which the fare setter can be changed and the incentive to facilitate this, FTWCRL and TPE may also have the ability and incentive to raise inter-available fares on this flow in the future.

107. On four other flows,<sup>81</sup> the Parties are the fare setter for the routed inter-available ticket,<sup>82</sup> while another TOC<sup>83</sup> sets an inter-available fare for the ‘any permitted’ ticket. The points made above in relation to the Carlisle - Penrith flow also apply to these flows. Additionally, the ‘any permitted’ tickets are generally little-used, because they are typically more expensive<sup>84</sup> whilst providing no advantage relative to the Parties’ routed inter-available fares.<sup>85</sup> Therefore, the CMA considers that the existence of these inter-available fares for which other TOCs are the fare setter does not remove the ability or incentive of the Parties to increase their own dedicated fares or routed inter-available fares on these flows.

108. Fifth, as regards the Parties’ argument that they would not want to further [✂] due to the [✂], the CMA notes that there is not currently sufficient certainty of [✂].<sup>86</sup> Moreover, the planned [✂] will not affect the overlap flows which fail the

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<sup>80</sup> The CMA understands that the relevant provision is Clause 4-28 of the Ticketing and Settlement Agreement.

<sup>81</sup> Carlisle – Lancaster, Carlisle – Preston, Edinburgh – Preston, and Glasgow – Preston.

<sup>82</sup> A routed inter-available fare is valid on any service taking a particular route (eg via a specific station). A ticket is ‘fully inter-available’ if, on a flow, a passenger is allowed to travel on any TOC on any potential route. See further, [Rail Guidance](#), paragraph 6.44(a).

<sup>83</sup> Northern for Carlisle – Lancaster and Carlisle – Preston, LNER for Edinburgh – Preston, and Glasgow – Preston.

<sup>84</sup> The exception is the anytime return tickets via any permitted route between Carlisle and Lancaster or Preston, for which Northern is the fare setter. The alternative tickets via Penrith, for which ICWC is the fare setter, are more expensive, and as a result the Northern-priced tickets are fairly popular. However, these tickets represent only a small share of the revenue from inter-available tickets on these flows, since most passengers opt for the off-peak ticket for which there is no Northern-priced alternative.

<sup>85</sup> On all of these flows the route offered by the Parties routed inter-available fare is the only practical route without incurring significant additional travel time.

<sup>86</sup> [✂].

filtering exercise. The Parties did not provide an explanation of how the [X] will affect the service quality on the overlap flows [X].

109. Sixth, in relation to the Parties' submission that the overlap between the TPE franchise and the Franchise will be of limited duration, the CMA notes that it follows from its past decisional practice that even an overlap of a time-limited nature can be sufficient for there to be a merger effect.<sup>87</sup> In this case, the duration of the overlap is for a period of between 3.5 and 6 years, taking into account the possible extension of the TPE franchise. This duration is sufficient to give rise to significant competition concerns, particularly given the merger effect identified in this case. The CMA also notes that there is significant headroom on each of the 17 overlap flows (see paragraph 90 above) indicating that there is a realistic prospect of a significant merger effect on each flow.
110. Seventh, as regards the Parties' argument that the relevant flows only represent a small part of the Parties' overall revenue, the CMA notes that all flows in Annex 1 have not been filtered out by the small flows filter. More generally, the CMA is of the view that the proportion of overall revenue in question does not remove the Parties' incentive to increase fares, since adjustment costs are low.<sup>88</sup> The Parties did not dispute that the direct administrative costs of such adjustments are low. Furthermore, the Parties' internal documents<sup>89</sup> indicate that the Parties consider price changes with relatively limited benefits and which are comparable to the potential benefits in this case. This supports the CMA's view on the relative ease and realistic prospect of the Parties having an incentive to increase fares on these flows, post Franchise Award.
111. In addition to the above arguments, the Parties submitted that the CMA has failed to explain how the potential raising of unregulated fares post-Franchise is merger-specific. In particular, the Parties noted that the raising of unregulated fares on TPE and the Franchise to the 'headroom' identified in the Issues Paper has been available to FirstGroup (vis-a-vis TPE) and Virgin (vis-a-vis the Franchise) before the Franchise Award and the fact that such changes have not been implemented prior to the Franchise Award indicates that other factors constrain the pricing of unregulated fares.

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<sup>87</sup> [Aer Lingus Limited / CityJet designated Activity Company](#).

<sup>88</sup> [Rail Guidance](#), para. 7.48 and footnote 114.

<sup>89</sup> For example, [X].

112. In this respect, as described above, the CMA considers that the Parties' rail services are close competitors in relation to each of these flows and this competition, in part, currently constrains TPE's and ICWC's fares. Therefore, this competition contributes to the existence of the current headroom and it is the loss of this competition which could lead to an increase in fares. Since this loss of competition is a result of the Franchise Award, it is clearly merger-specific.
113. Finally, the Parties submitted that the Haymarket – Penrith North Lakes flow only narrowly fails the small flows filter.<sup>90</sup> The CMA considers that the turnover generated on this flow is more than the £20,000 threshold used in the small flows filter and that:
- (a) regulated fares currently account for none of ICWC's or TPE's revenues on this flow;
  - (b) there are no other competing TOCs on this flow which might constrain the Parties;
  - (c) this flow is part of the larger stretch of track between Edinburgh and Wigan North Western on which the CMA considers that the Franchise Award will lead to significant competition concerns on multiple flows; and
  - (d) if Edinburgh is treated as a single settlement, in accordance with the Rail Guidance, the turnover generated by the Edinburgh – Penrith North Lakes flow is well above the small flows filter threshold.
114. On this basis, the CMA considers that, in the absence of other competing TOCs, the overlapping TOCs are close competitors in relation to these flows. The CMA therefore believes that the Parties are likely to have an incentive to increase fares on these flows.

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<sup>90</sup> The Parties also made similar submissions in relation to a number of other flows, although the revenues of both ICWC and TPE are higher on these flows and the CMA considers that the same points apply to these additional flows.

- *Third parties' views*

115. Several third parties (including passengers, local authorities and competitors of the Parties) expressed their concerns regarding the impact on competition of the Franchise Award.
116. One third party expressed concerns that, over time, there could be rationalisation and consolidation between key destinations or stops on the route between Carlisle, Penrith North Lakes, Oxenholme Lake District, Lancaster, and Preston. This third party said that there is also a risk that fares could be increased because of a lack of competition between operators on sections of this route.
117. Another third party considered that the Franchise Award could have a significant impact on competition for the rail services particularly in terms of increased fares due to FTWCRL and TPE not competing on price, and a lack of alternative choice of services. This third party said that the Franchise Award could result in reduced frequency and/or reduced service quality on a number of flows.
118. Another third party expressed concerns that since TPE already operates services between Scotland and Manchester, the Franchise Award would give FirstGroup a 'complete monopoly of all rail operations along this major commuting line.' This third party explained that whilst currently rail passengers from stations including Glasgow, Edinburgh, Lockerbie, Carlisle, Oxenholme and Lancaster have a choice between the current ICWC operator and TPE for their journey to destinations within Cumbria and Lancashire, following the Franchise Award 'this choice is eliminated.' This third party expressed concerns regarding the potential impact of the Franchise Award on fares, stating that: 'the proposed monopoly for FirstGroup will have a negative impact on rail fares, regular commuters and the travelling public.'
119. The CMA also received a complaint from a third party who was concerned that the Franchise Award would lead to 'large price increases and reduced quality of service'. In particular, this third party commented that the Franchise Award will ['not lessen competition but remove it entirely' on Carlisle - Glasgow flow, and that if the Franchise Award goes ahead, 'then FirstGroup ... can ... charge what they like.' As regards competitive constraints from other TOCs on this flow, this third party said that 'the only other service from Carlisle to Glasgow is the non-mainline [ScotRail] service which is very expensive, not as regular and takes about 2.5 hours each way as opposed to just over an hour each way via Virgin or FTP, so is obviously not viable.'"]



- *Conclusion*

120. Since the Parties are each other's only competitor; since the Parties will have the ability and incentive to raise unregulated fares after the Franchise Award; and having regard to concerns raised by third parties, the CMA found that, for each of the 17 flows (listed in Annex 1) separately, the Franchise Award gives rise to significant competition concerns.

*Flows where the Parties face competition from one other TOC post-Franchise Award*

121. On four flows (listed in Annex 2), the Parties will continue to face competition from one other TOC post-Franchise Award. The other TOC operating a competing service on these flows is Northern (for three flows) or ScotRail (for one flow). The increment to the Parties' share of rail services on these flows is substantial: at least [20-30]% and on average [30-40]% by passenger revenue and at least [20-30]% and on average [30-40]% by number of trains. Post-Franchise Award, the Parties' lowest combined share of supply on these four flows will be [80-90]% by revenue and [80-90]% by number of trains.
122. On two of the four flows (Oxenholme – Lancaster; Lancaster – Preston),<sup>91</sup> ICWC is the fare setter for inter-available fares, while both Parties have dedicated fares on all four flows.
123. Regulated fares account for only a small proportion of revenues on these flows (no more than [20-30]%).<sup>92</sup> On some of these flows, dedicated fares account for only a small proportion of revenue for one of ICWC or TPE. For example, on Lancaster – Oxenholme, [90-100]% of ICWC's revenue comes from inter-available fares. However:
- (a) for each flow at least one of the Parties generates a substantial proportion of revenue from dedicated fares (see Annex 2). In particular, on the Lancaster – Oxenholme flow where [90-100]% of ICWC's revenue is from inter-available fares, TPE generates [40-50]% of its revenue from dedicated fares; and

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<sup>91</sup> The other two flows (where the fare setter is Northern) will be discussed in more detail in paragraph 137-138 below.

<sup>92</sup> For ICWC on average [10-20]% and at most [20-30]% (Preston – Lancaster) and for TPE on average [5-10]% and [20-30]% at most (Preston – Lancaster).

(b) as set out in the Rail Guidance, dedicated fares can be a material constraint even if they are little used.<sup>93</sup>

- *Closeness of competition*

124. As shown in Annex 2, the CMA considers that services on ICWC and TPE have very similar characteristics as regards journey times<sup>94</sup> and both offer frequent services.<sup>95</sup>
125. The similarities in journey times and travel costs are reflected in the GJC analysis provided by the Parties. 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. This analysis shows that for each of the flows the GJC difference for ICWC and TPE is below the 25% threshold mentioned in the Rail Guidance. This finding is consistent across the different assumptions that could be made to calculate the GJC.
126. The Parties submitted that there are substantial differences in frequency in train departures between ICWC and TPE and that, therefore, the Parties are not close competitors.
127. The CMA notes that passenger train services are relatively homogenous services, as discussed at paragraph 84 above. Moreover, both Parties offer at least 111 departures per week each on all four of these flows, ie on average at least 15 trains per day. This indicates that a significant number of the Parties' services are likely to be viewed as close alternatives by passengers.
128. Any consideration of the similarities of the Parties' services must also be placed in the context of the similarity of their services with those of the other competing TOC. The Parties offer significantly more services on each of these flows than the other competing TOC. In the case of the Oxenholme-Lancaster and Oxenholme-Preston flows, they offer over three times as many services as the competing TOC. The services of the competing TOCs are also slower than the Parties and, in the case of Glasgow – Carlisle, this difference is very significant.<sup>96</sup> Therefore, the CMA considers that the characteristics of the Parties' services

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<sup>93</sup> Rail Guidance, paragraph 6.43(b).

<sup>94</sup> At most 12 minutes for a journey lasting over an hour (Glasgow – Carlisle) and on three of the flows, no more than one minute.

<sup>95</sup> At least 111 weekly departures; an average of at least 15 services per day (TPE on Glasgow – Carlisle).

<sup>96</sup> Over 60 minutes on a journey time of 71 minutes for the Franchise and 83 minutes for TPE.

indicate that they are likely to be close competitors relative to the other TOCs on this flow.

129. This assessment is consistent with the revenue retention ratios for these flows which indicate that the non-fare characteristics of ICWC's and TPE's services make them close competitors. For three flows (namely, Oxenholme – Lancaster, Oxenholme – Preston, and Glasgow – Carlisle) the revenue retention ratios<sup>97</sup> are very high (between [80-90]% and [90-100]%) for both Parties. For the Lancaster – Preston flow the revenue retention ratio for TPE is high at [80-90]% whilst it is lower but still considerable ([50-60]%) for ICWC. The CMA considers that this is consistent with the greater frequency of ICWC Services on this route relative to the frequency of TPE or Northern services, meaning that ICWC's services are a stronger constraint on TPE's services than vice-versa. As noted in the CMA's Rail Guidance, revenue retention ratios of this magnitude mean that two TOCs are likely to be each other's closest competitors.<sup>98</sup>
130. The CMA therefore believes that that the overlapping TOCs are close competitors on these flows.

- *Ability and incentive to increase fares*

131. As set out in paragraphs 91 above, respectively, the Parties submitted that they do not have a meaningful ability and/or incentive to increase unregulated fares, including in relation to these four flows. The Parties' submissions regarding: (i) the JV arrangement; (ii) the need for a coherent price structure; (iii) minimal overlaps accounting for a small proportion of total revenue; (iv) limited duration of overlap between the TPE franchise and the Franchise; (v) plans of [redacted]; (vi) passengers being leisure customers; (vii) competitive constraint from other modes of transport, such as cars; (viii) split-ticketing and travelling short; (ix) proportion of revenue on these flows coming from inter-available fares set by third-party operators; and (x) the Parties' unwillingness [redacted] due to the [redacted] by increasing fares, were general submissions rather than being specific to these flows and have been discussed above.

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<sup>97</sup> As noted in the [Rail Guidance](#) (para 7.38), revenue retention ratios are based on non-fare characteristics of alternative services and does not account for any trade-offs between fares and other characteristics. Revenue retention ratios also do not consider possible diversion to non-rail alternatives. Therefore, the CMA has considered revenue retention ratios alongside the other evidence.

<sup>98</sup> [Rail Guidance](#), paragraph 7.44.

132. The CMA considers that its conclusions above equally apply in respect of these four flows.
133. The CMA considers that there is sufficient headroom for the Parties to implement price increases on each of the four flows.<sup>99</sup> The CMA's calculations indicate that on each of these flows there is headroom of at least £[£] and on some of the flows the headroom is considerably higher. Therefore, the CMA considers that the Parties have the ability to increase fares on these flows.<sup>100</sup>
134. In assessing the incentive to increase fares, the Rail Guidance describes how the CMA considers the closeness of competition between the overlapping TOCs, the competition the overlapping TOCs face from other TOCs on the same flow and any evidence of adjustment costs.<sup>101</sup>
135. As described above, the CMA considers that the overlapping TOCs are close competitors in relation to each of these flows. While the Parties will continue to face competition from another TOC on these flows, as described above, the competing TOCs account for a substantially smaller share of revenue (no more than [10-20]%) and departures (no more than [20-30]%) than either of the Parties. In addition, on the Glasgow – Carlisle flow, the competing ScotRail service has a significantly longer journey time than ICWC or TPE, indicating that it is unlikely to be a close alternative.<sup>102</sup>
136. Therefore, the CMA considers that post-Franchise Award there would be a significant reduction in competition between TOCs on these flows given the closeness of competition between FTWCLR and TPE relative to the constraint from the competing TOC. This indicates that the Parties are likely to have an incentive to increase fares on each of these flows.
137. The CMA has considered whether the proportion of revenue due to inter-available fares set by third parties on these flows would mean that the Parties do not have a meaningful ability and/or incentive to increase fares. The CMA notes that the Franchise is the fare setter for two of the four flows in Annex 2, namely the Oxenholme – Preston and Glasgow – Carlisle. Therefore, the Parties'

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<sup>99</sup> The CMA's approach to calculating headroom is set out in footnote 69 above.

<sup>100</sup> The Parties made a number of submissions that they would not have the ability to raise fares due to substitution to other alternatives. The CMA has considered these submissions as part of its incentive assessment.

<sup>101</sup> Rail Guidance, para 7.30-7.48.

<sup>102</sup> The ScotRail service takes 2 hours 27 minutes compared to 1 hour 11 minutes for the Franchise and 1 hour 23 minutes for TPE.

argument that inter-available fares are set by third parties is not relevant with regard to these two flows.

138. In relation to the Oxenholme – Lancaster and Lancaster – Preston flows, both ICWC and TPE have dedicated fares on these two flows and these dedicated fares compete with and constrain Northern’s inter-available fares. Therefore, the CMA considers that any loss of competition between FTWCLR and TPE which leads to an increase in their dedicated fares is likely to reduce the competitive constraint on the inter-available fares. As a result, the inter-available fare could also increase. The CMA, therefore, does not agree that Northern’s inter-available fare mitigates the Parties’ ability to increase fares post-Franchise Award. Further, as described above, the CMA’s current view is that Northern is not as close a competitor to FTWCLR and TPE on these flows as FTWCLR and TPE are to each other. Therefore, the CMA does not believe that Northern’s setting of the inter-available fares on this flow would remove the Parties’ incentive to increase the fares that they control.

- *Third parties’ views*

139. In addition, a third party that responded to the CMA’s investigation expressed the view that ICWC and TPE are close competitors, and that, in particular, the current rail services offered by ICWC and TPE between Preston and Carlisle (including Oxenholme – Lancaster; Oxenholme – Preston; Lancaster – Preston flows) are similar in terms of journey duration, fares, frequencies and times of operation (noting, however, that the services differ in quality).
140. Similarly, another third party considered that on overlaps between Edinburgh – Glasgow, as well as between Carlisle, Penrith North Lakes, Oxenholme Lake District, Lancaster, and Preston stations, including the four flows considered in this part of the Decision, TPE and ICWC provide a comparable number of services with relatively similar journey times, timetables and fares.
141. A third party considered that the Franchise Award could have a significant impact on competition for the rail services on these flows, particularly in terms of increased fares due to the Franchise and TPE not competing on price, and a lack of alternative choice of services. This third party said that the Franchise Award could result in reduced frequency and / or reduced service quality on these flows.

- *Conclusion*

142. On the basis that the Parties are each other's closest competitor, the Parties will compete with only one other TOC, and the Parties will have the ability and incentive to raise unregulated fares after the Franchise Award, the CMA found that, for each of the four flows (listed in Annex 2) separately, the Franchise Award gives rise to significant competition concerns.

*Expansion flows*

143. There are two flows (set out at Annex 3) where the Parties' current revenues would lead to the flows being excluded by the small flows filter but where plans to expand the services offered on these flows could lead to an increase in revenues such that this is no longer the case in the foreseeable future.

144. Specifically, the Parties submitted that:

(a) FirstGroup has agreed with Transport for the North to extend the operation of the TPE franchise in October 2019 with the introduction of a service between Liverpool and Glasgow service running six trains per day. This will lead to a significant increase in the number of TPE departures on the Wigan North Western – Preston flow; and

(b) there are a number of planned service changes to the Franchise that will be introduced after December 2022. This will result in additional Franchise services on the Carlisle – Motherwell flow.

145. Based on current services, TPE operates only one departure a week on the Wigan North Western – Preston flow but this will increase to 48 departures a week. If TPE were to earn the same revenue per departure following this expansion as it did in FY17/18, TPE's annual revenue on this flow would be £[REDACTED] and the flow would not have failed the small flows filter.

146. Likewise, based on current services, ICWC operates 50 departures a week on the Carlisle - Motherwell flow but this will increase to 198. If ICWC were to earn the same revenue per departure following this expansion as it does currently, ICWC's annual revenue would be £[REDACTED].

147. Therefore, the CMA considered it appropriate to include these flows in its competitive assessment.

- *Wigan North Western – Preston*

148. The expansion on this flow relates to the services offered by TPE and is therefore not part of the Franchise Award. Consequently, the CMA considers that this expansion would occur regardless of whether FTWCRL has been awarded the Franchise (ie it would also have occurred in the counterfactual).
149. On this flow, the Franchise Award would reduce the number of TOCs from three to two, with the Parties facing competition from one other TOC, Northern. Northern is the fare setter on this flow and offers some dedicated fares on this flow. ICWC also offers dedicated fares on this flow. TPE submitted that it currently has no plans to introduce dedicated fares on this flow.
150. The Parties submitted that after TPE's expansion, it will still only operate 10% of the number of departures of ICWC on Wigan North Western – Preston and 5% of all departures on the flow.<sup>103</sup>
151. ICWC and Northern have a comparable number of weekly departures and will both have significantly more departures than TPE in the future.<sup>104</sup> Although, ICWC accounts for [70-80]% of the revenue on this flow and has a considerably wider range of dedicated fares than Northern on this flow, the CMA considers that ICWC will compete significantly more closely with Northern than it will with TPE. In particular, the significantly smaller number of TPE departures (even post-expansion) will limit the competitive constraint TPE could provide on this flow.
152. Consequently, the CMA considers that this small increment is not sufficiently significant, on its own, to create an incentive for ICWC (the only one of the Parties' TOCs with dedicated fares) to increase prices on this flow.

- *Conclusion*

153. Therefore, for the reasons above, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on the Wigan North Western – Preston flow.

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<sup>103</sup> In contrast to cases in other sectors, the scope for TPE to expand its share of capacity is limited given the timetabling constraints involved.

<sup>104</sup> ICWC currently has 490 weekly departures, Northern 412 and TPE will have 48.

- *Motherwell – Carlisle*

154. The Parties submitted that the proposed additional Franchise services between Motherwell and Carlisle after December 2022 did not give rise to an SLC and that FTWCRL included the expansion in its bid for the Franchise as it was ‘evidently pro-consumer and to the benefit of customers’.
155. The CMA received evidence from the DfT that the expansion of the services on the Motherwell – Carlisle flow was specific to FTWCRL’s bid and that, absent the Award to FTWCRL the additional services would not have been part of the Franchise. For this reason, the CMA has not considered the additional services in its competitive assessment of the flow. Absent the additional services, the flow is excluded from further analysis based on the small flows filter.

- *Conclusion*

156. For the reasons above, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on the Motherwell – Carlisle flow.

- *Manchester Piccadilly – Stockport*

157. On this flow, Transport for Greater Manchester is the fare setter and both ICWC and TPE have dedicated (walk-up) fares. In addition to ICWC and TPE, four other TOCs operate on this flow.<sup>105</sup> Accordingly, ICWC and TPE account for a moderate share of departures on this flow (19% and 7%, respectively). Northern accounts for the greatest number of departures (approx. 47%) although its services are four minutes (and 50%) slower due to an additional two stops.
158. The Franchise and TPE will have a high combined share of supply by revenue ([60-70]%, with an increment of [10-20]%) on this flow post-Franchise Award. ICWC and TPE are two of only three TOCs offering dedicated fares on this flow. The high combined share of supply by revenue and decision to offer dedicated fares is consistent with ICWC and TPE being particularly active in fare related competition on this flow.
159. However, the number of competing TOCs on this flow and ICWC’s and TPE’s moderate share of departures are consistent with passengers having a number

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<sup>105</sup> Cross Country, Northern, Transport for Wales, and East Midlands Trains (EMT).



of comparable alternatives following the Franchise Award that would continue to constrain the Parties. This assessment based on non-fare characteristics is consistent with the relatively low revenue retention ratio on this flow.<sup>106</sup> The Parties noted that these revenue retention ratios are significantly below the 50% threshold described in the Rail Guidance, below which the CMA will generally not find a competition problem.<sup>107</sup> The CMA also received evidence that the characteristics of the services (eg train capacity and quality) offered by the TOCs on this flow meant that the ICWC's services are most comparable to those of Cross Country, whereas TPE's services are more comparable to Transport for Wales (**TfW**), Northern and EMT.

160. Therefore, the CMA considers that there will be sufficient competition from other TOCs to constrain the Parties following the Franchise Award. Consistent with this assessment, third parties which responded to the CMA's investigation, including Manchester City Council, did not raise any concerns in relation to the possible impact of the Franchise Award on competition on this flow.

○ *Conclusion*

161. For the reasons set out above, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on the Manchester Piccadilly – Stockport flow.

*The future overlap between London and Edinburgh*

162. As stated above in paragraph 17, FirstGroup is expected to commence an open access operator service (East Coast Trains) between London and Edinburgh in 2021. This would create one additional overlap between the services currently operated by ICWC (from London via Birmingham to Edinburgh on the West Coast Mainline) and East Coast Trains (which is a direct route from London to Edinburgh via the East Coast Mainline).
163. ICWC currently offers 42 direct services from London to Edinburgh a week,<sup>108</sup> whilst East Coast Trains will offer 35 direct services a week. London North Eastern Railway (**LNER**) operates the East Coast franchise and currently offers 133 direct services a week between London and Edinburgh. The LNER and East

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<sup>106</sup> [5-10]% for removal of a service on the Franchise and [20-30]% for removal of a service on TPE.

<sup>107</sup> Rail Guidance, paragraph 7.44.

<sup>108</sup> ICWC also offers additional indirect services, for example changing at Preston.

Coast Trains direct services will be significantly quicker than the direct services that will be offered by FTWCRL (currently offered by ICWC) (50-80 minutes).

164. The CMA considers that the service frequency and differences in travel time illustrate that LNER is the primary TOC on this flow and that it is likely to continue to offer an effective competitive constraint to both FTWCRL and East Coast Trains following the Franchise Award. Further, the differences in journey times between the East Coast Trains and FTWCRL services indicate that customers are less likely to see the services offered by the TOCs as alternatives and that East Coast Trains and FTWCRL are unlikely to compete closely on this flow.
165. This is consistent with the other evidence the CMA has received, specifically the East Coast Trains business case (as submitted to the Office of Rail and Road (**ORR**)) and MOIRA modelling undertaken by the ORR indicated that almost the entire impact of East Coast Trains on existing TOCs would be attributable to the East Coast franchise.<sup>109</sup>
166. Therefore, in light of the evidence that East Coast Trains and FTWCRL are unlikely to be close competitors on the London – Edinburgh flow and since East Coast Trains and FTWCRL will continue to face strong competition from the East Coast franchise on this flow, the CMA believes that the Franchise Award will not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on the London - Edinburgh flow.

- *Conclusion*

167. For the reasons set out above, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects on the flow arising from future overlap between London and Edinburgh.

### *Bus-rail overlaps*

168. The CMA also considered whether common ownership of overlapping bus and rail services could give FirstGroup the ability and incentive to increase fares

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<sup>109</sup> MOIRA is a rail industry standard model and is used in the industry, and by the DfT, to estimate passenger allocation in response to changes to services, such as time table changes. MOIRA does not include fare information and so allocates passengers based solely on non-fare characteristics (eg journey time and frequency). Thus, this analysis indicates that the non-fare characteristics indicate that LNER is the primary competing TOC on this flow and that ECTL and FTWCRL are unlikely to compete closely.

and/or reduce non-price aspects of bus services (such as service quality, frequency or operational performance) on the overlapping bus flows.

169. There are ten bus-rail overlaps between the Franchise and FirstGroup's bus services. In line with the Rail Guidance, the CMA undertook a filtering methodology<sup>110</sup> to exclude from further analysis overlapping flows on which an SLC is least likely.<sup>111</sup> Seven flows were removed by the route revenue filter and three further flow(s) were removed by the overlapping bus revenue filter. While the filters are not intended to provide a complete decision rule, the CMA found no evidence (such as internal documents or comments from third parties) to suggest that competition concerns may arise on flows that were excluded by the filters.<sup>112</sup>
170. Accordingly, the CMA found that the Franchise Award does not give rise to a realistic prospect of an SLC as a result of horizontal unilateral effects in relation to any of the bus-rail overlaps.

#### *Conclusion on horizontal unilateral effects*

171. For the reasons set out above, the CMA found that the Franchise Award raises significant competition concerns as a result of horizontal unilateral effects in relation to each of the following rail-rail flows separately:

(a) 17 flows on which the Parties are the only TOCs offering train services:

- (i) Carlisle – Penrith
- (ii) Carlisle – Oxenholme
- (iii) Carlisle – Lancaster
- (iv) Carlisle – Preston
- (v) Penrith – Lancaster
- (vi) Penrith – Preston
- (vii) Edinburgh – Carlisle
- (viii) Edinburgh – Penrith
- (ix) Edinburgh – Oxenholme
- (x) Edinburgh – Lancaster
- (xi) Edinburgh – Preston
- (xii) Glasgow – Lockerbie
- (xiii) Glasgow – Penrith

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<sup>110</sup> Rail Guidance, paragraph 6.10 onwards.

<sup>111</sup> Rail Guidance, paragraph 6.2.

<sup>112</sup> Rail Guidance, paragraph 6.3.

- (xiv) Glasgow – Oxenholme
- (xv) Glasgow – Lancaster
- (xvi) Glasgow – Preston
- (xvii) Motherwell – Preston

(b) Four flows on which the Parties face competition from one other TOC post-Franchise Award:

- (i) Oxenholme – Lancaster
- (ii) Oxenholme – Preston
- (iii) Lancaster – Preston
- (iv) Glasgow – Carlisle

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

172. 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.<sup>113</sup>
173. The Parties did not provide any flow-specific 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.

### ***Conclusion on substantial lessening of competition***

174. 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 the public transport services on each of the flows separately listed in paragraph 171 above.

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<sup>113</sup> [Merger Assessment Guidelines](#), from paragraph 5.8.1.

## Exceptions to the duty to refer

175. 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.
176. The Parties submitted that the CMA should exercise its discretion not to refer for the following reasons:
- (a) The flows where the Parties and the Franchise provide overlapping services constitute a very small fraction of total revenue (~~1~~% or £~~1~~ million out of £~~1~~ million, when Manchester Piccadilly – Stockport and the Expansion flows are excluded from the overlap flows). The Parties submitted that this amount of revenue is only marginally above the £15 million market size referred to in the CMA's Guidance on Exceptions to the duty to refer.<sup>114</sup>
  - (b) The majority of individual overlaps on the identified flows are very small, with nearly half earning revenues below £1 million. As such, the Parties submitted that the impact of the Franchise Award on the identified overlap flows can also be said to be *de minimis* as regards the substantial majority of the flows concerned.
177. First, the CMA notes that, in accordance with its Guidance on Exceptions to the duty to refer, the CMA will consider that the market(s) concerned are generally of sufficient importance to justify a reference (such that the exception will not generally be applied) where the annual value in the UK of the market(s) concerned is more than £15 million in aggregate.<sup>115</sup> In this case, the annual value of the Parties' revenue in the flows listed in Annex 1 and Annex 2 (is above the £15 million market size threshold and the annual value of the markets concerned is higher again once third party revenue on the flows listed in Annex 2 is included. Contrary to the Parties' submissions, where the test for reference is met in multiple markets, the relevant figure is the aggregate size of all such markets, and not the size of individual affected markets.<sup>116</sup> Accordingly, the CMA

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<sup>114</sup> *Mergers: Exceptions to the duty to refer*, CMA64, December 2018.

<sup>115</sup> *Mergers: Exceptions to the duty to refer*, paragraph 8.

<sup>116</sup> *Mergers: Exceptions to the duty to refer*, paragraph 37.

believes that the markets concerned are of a size that indicate they are of sufficient importance to justify a reference.

178. Second, 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.<sup>117</sup> In this case, the CMA has identified an SLC in relation to 21 rail-rail overlaps. 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.<sup>118</sup> 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 *Abellio East Midlands / East Midlands, 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 suggest that similar undertakings would not be available to resolve the competition concerns found in this case. The CMA therefore considers that undertakings in lieu of reference may in principle be available in this case.

#### *Conclusion on the application of the de minimis exception*

179. Taking the above factors into consideration, the CMA believes that the markets concerned in this case are of sufficient importance to justify the making of a reference. As such, the CMA does not believe that it is appropriate for it to exercise its discretion to apply the *de minimis* exception.

## **Decision**

180. 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.

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<sup>117</sup> *Mergers: Exceptions to the duty to refer*, CMA64, paragraph 28.

<sup>118</sup> *Merger remedies*, CMA 87, December 2018, paragraph 3.32.

181. 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.<sup>119</sup> The Parties have until 14 November 2019<sup>120</sup> to offer an undertaking to the CMA.<sup>121</sup> The CMA will refer the Franchise Award for a phase 2 investigation<sup>122</sup> 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 decides<sup>123</sup> by 21 November 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**  
**Competition and Markets Authority**  
**7 November 2019**

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#### Endnotes

In relation to paragraph 119, the text in square brackets was erroneously omitted in the version of the Decision sent to the Parties.

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<sup>119</sup> Section 33(3)(b) of the Act.

<sup>120</sup> Section 73A(1) of the Act.

<sup>121</sup> Section 73(2) of the Act.

<sup>122</sup> Sections 33(1) and 34ZA(2) of the Act.

<sup>123</sup> Section 73A(2) of the Act.

### Annex 1: Flows on which the Parties are the only TOCs offering train services

Flow	Fares Setter	Journey Time		Frequency (per week)		SoS Increment		IA share		Reg Share		Generalised Journey Cost		
		WC	TPE	WC	TPE	Revenue	Trains	WC	TPE	WC	TPE	WC	TPE	Differential
Carlisle – Penrith	XCo	00:13:25	00:14:09	204	180	[40-50]%	47%	[50-60]%	[50-60]%	[10-20]%	[10-20]%	[13-20]	[10-20]	14%
Carlisle – Oxenholme	WC	00:35:53	00:38:13	273	199	[40-50]%	42%	[50-60]%	[40-50]%	[0-5]%	[0-5]%	[10-20]	[10-20]	8%
Carlisle – Lancaster	WC*	00:49:45	00:52:22	366	213	[40-50]%	37%	[50-60]%	[50-60]%	[0-5]%	[0-5]%	[30-40]	[30-40]	14%
Carlisle – Preston	WC*	00:52:14	00:54:30	204	180	[40-50]%	47%	[40-50]%	[30-40]%	[0-5]%	[0-5]%	[30-40]	[30-40]	17%
Penrith – Lancaster	WC	00:35:20	00:37:19	188	180	[40-50]%	49%	[80-90]%	[50-60]%	[50-60]%	[10-20]%	[20-30]	[20-30]	17%
Penrith – Preston	WC	00:52:14	00:54:30	204	180	[40-50]%	47%	[40-50]%	[30-40]%	[0-5]%	[0-5]%	[30-40]	[30-40]	17%
Edinburgh – Carlisle	TPE	01:15:35	01:20:45	93	113	[40-50]%	45%	[10-20]%	[20-30]%	[0-5]%	[0-5]%	[50-60]	[60-70]	19%
Edinburgh – Penrith	TPE	01:31:52	01:36:59	49	70	[40-50]%	41%	[10-20]%	[30-40]%	[0-5]%	[0-5]%	[60-70]	[70-80]	18%
Edinburgh – Oxenholme	TPE	01:53:18	02:00:35	52	94	[40-50]%	36%	[10-20]%	[20-30]%	[0-5]%	[0-5]%	[60-70]	[70-80]	18%
Edinburgh – Lancaster	TPE	02:07:42	02:14:35	93	102	[30-40]%	48%	[10-20]%	[10-20]%	[0-5]%	[0-5]%	[60-70]	[80-90]	21%
Edinburgh – Preston	TPE*	02:24:38	02:31:56	93	113	[50-60]%	45%	[20-30]%	[10-20]%	[0-5]%	[0-5]%	[70-80]	[60-70]	18%
Glasgow – Lockerbie	WC	00:57:09	01:02:40	37	109	[10-20]%	25%	[50-60]%	[20-30]%	[20-30]%	[5-10]%			
Glasgow – Penrith	WC	01:27:24	01:40:59	155	110	[30-40]%	42%	[30-40]%	[20-30]%	[10-20]%	[0-5]%	[30-40]	[30-40]	11%
Glasgow – Oxenholme	WC	01:49:49	02:05:32	221	105	[20-30]%	32%	[30-40]%	[20-30]%	[0-5]%	[0-5]%	[40-50]	[30-40]	15%
Glasgow – Lancaster	WC	02:03:14	02:19:51	273	111	[20-30]%	29%	[30-40]%	[20-30]%	[5-10]%	[0-5]%	[70-80]	[60-70]	7%



Flow	Fares Setter	Journey Time		Frequency (per week)		SoS Increment		IA share		Reg Share		Generalised Journey Cost		
		WC	TPE	WC	TPE	Revenue	Trains	WC	TPE	WC	TPE	WC	TPE	Differential
Glasgow – Preston	WC*	02:19:58	02:36:56	303	111	[20-30]%	27%	[20-30]%	[20-30]%	[0-5]%	[0-5]%	[80-90]	[60-70]	20%
Motherwell – Preston	WC	02:07:26	02:17:19	50	93	[40-50]%	35%	[10-20]%	[20-30]%	[5-10]%	[0-5]%	[70-80]	[80-90]	1%

Note: The GJC figures quoted are for an anytime single ticket and a leisure passenger. However, the other calculations submitted by the Parties are not materially different.

Where the fares setter is marked with an \*, there is another TOC that is the fares setter for at least some fares on this flow.

**Annex 2: Flows in which the Parties face competition from one other TOC  
post-Franchise Award**

Flow	Oxenholme – Lancaster	Oxenholme – Preston	Lancaster – Preston	Glasgow – Carlisle
Fares Setter	NO	WC	NO	WC
Journey time (WC)	00:12:27	00:29:11	00:15:07	01:11:23
Journey time (TPE)	00:12:56	00:30:08	00:15:56	01:23:25
Journey time (3rd party)	00:16:45	00:38:15	00:19:04	02:27:18
Frequency (per week, WC)	254	273	385	303
Frequency (per week, TPE)	199	199	219	111
Frequency (per week, 3rd party)	30	56	140	106
SoS increment (revenue)	[30-40]%	[40-50]%	[20-30]%	[20-30]%
SoS increment (departures)	41%	38]%	29%	24%
Combined SoS (revenue)	[90-100]%	[90-100]%	[80-90]%	[90-100]%
Combined SoS (departures)	94%	89%	81%	780%
IA share (WC)	[90-100]%	[80-90]%	[60-70]%	[40-50]%
IA share (TPE)	[50-60]%	[40-50]%	[60-70]%	[30-40]%
Reg share (WC)	[10-20]%	[10-20]%	[20-30]%	[0-5]%
Reg share (TPE)	[5-10]%	[5-10]%	[20-30]%	[0-5]%
GJC Differential	12%	15%	7%	3%
RR (WC)	[90-100]%	[90-100]%/[80-90]%	[50-60]%	[90-100]%/[90-100]%
RR (TPE)	[90-100]%	[80-90]%/[80-90]%	[80-90]%	[90-100]%/[90-100]%

Note: Where the Revenue Retention Ratios (RR) are different depending on which station is removed, both results are given. (“Remove Station 1”/“Remove Station 2”)

### Annex 3: Expansion flows

Flow	Wigan NW - Preston	Motherwell - Carlisle
Fares Setter	NO	WC
Current Journey time (WC)	11.39	57.21
Current Journey time (TPE)	22.00	1.04.22
Journey time (3rd party)	18.41	N/A
Current Frequency (per week, WC)	490	50
Current Frequency (per week, TPE)	1	93
Future Frequency (per week, WC)	490	148
Future Frequency (per week, TPE)	49	98
Frequency (per week, 3rd party)	412	N/A
Future SoS increment (departures)	5%	40%
Future Combined SoS (departures)	57%	100%
Current IA share (WC)	[50-60]%	[40-50]%
Current IA share (TPE)	[60-70]%	[40-50]%
Current Reg share (WC)	[10-20]%	[30-40]%
Current Reg share (TPE)	[20-30]%	[5-10]%

Note: The CMA understands that TPE currently does not offer any dedicated fares on Wigan NW – Preston, meaning that currently all its revenue on that flow is from inter-available fares.