

CMA Merger Review of InterCity East Coast Franchise

Conditional clearance the most likely outcome (February 2015)

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The CMA's Phase 1 merger review

On 6 February 2015, the Competition and Markets Authority ("CMA"), announced its decision to refer the award of the InterCity East Coast ("ICEC") franchise to InterCity Railways Limited ("ICRL") for an in-depth "Phase 2" merger review because of competition concerns on two routes.

On 20 February 2015, the CMA announced that ICRL has submitted proposed "undertakings in lieu" ("UILs") in an attempt to avoid a Phase 2 merger review. The CMA believes that the UILs are likely to be able to address fully its competition concerns. If final UILs are not agreed and formally accepted, the CMA must refer the deal for a formal Phase 2 review. **Figure 1** below outlines the CMA's review timeline.

The franchise award

ICEC has been publicly run since 2009. On 23 October 2013, the Department for Transport ("DfT") announced an open competition to select a franchisee to operate the passenger rail franchise for eight years from March 2015.

The shortlisted bidders were:

- East Coast Trains Ltd;
- Keolis/Eurostar East Coast Limited and Eurostar International Limited; and
- ICRL (a Stagecoach and Virgin Trains JV).

A formal Invitation to Tender was issued on 21 March 2014. DfT announced its decision to award the franchise to ICRL on 27 November 2014.

CMA approach to rail passenger franchise awards

Entering into a franchise agreement generally constitutes an acquisition of control of an enterprise under UK merger control law. Subject to the structure and size of the franchise award, the CMA can review almost all franchise awards.

For passenger rail concessions and equivalent non-franchise awards, the bidder's ability to exercise control of commercial strategy will affect whether the award constitutes a reviewable merger. For example, MTR's recent award of the Crossrail concession was not a reviewable merger

because Transport for London retained control over Crossrail's commercial strategy, including over price and operational service levels, as well as customer-facing and marketing activities.

For reviewable mergers, the CMA typically assesses competition on a local route-level basis, taking into account demand-side factors (such as passenger preferences) and supply-side factors (such as bus and rail competitive constraints – see e.g. the *Thameslink, Southern and Great Northern Franchise* review).

ICEC competition issues are limited to two overlap routes

The CMA identified competition concerns on two routes where ICEC rail services overlap with coach and rail services operated by Stagecoach:

- overlap of ICEC rail services with Stagecoach-operated East Midland rail services between Peterborough and Grantham, and Peterborough and Lincoln; and
- overlap of ICEC rail services with Citylink's coach services (operated and jointly owned by Stagecoach) between Edinburgh and Dundee, and Edinburgh and Aberdeen.

The CMA acknowledges that rail services are highly regulated and governed by "increasingly prescriptive franchise agreements". Nonetheless, given the ICEC overlaps identified, the CMA has concluded that the award to ICRL creates a realistic risk of higher fares or reduced service on the overlap routes.

The CMA also expressed concern that the award to ICRL may result in higher coach fares or reduced quality on the overlap routes, particularly given that coach services are unregulated.

CMA has until 21 April to agree UILs

The CMA previously indicated that UILs are likely to be able to address its competition concerns. Accordingly, Stagecoach has offered the following UILs on the overlap rail and coach routes:

- East Midlands rail journey UILs – price cap on certain fares set by East Midlands Trains, with ongoing monitoring of such fares by the CMA.
- Citylink coach journey UILs – Stagecoach will not take decisions (e.g. relating to fares,

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timetables, service quality) which may impact the competitiveness of the coach services vis-à-vis the overlap rail journeys.

The CMA must now consult on and formally accept final UILs by 21 April 2015 (50 working days – extendable by up to 40 working days). If UILs are not formally accepted, the CMA must refer the deal for a formal Phase 2 review. In principle a Phase 2 review could result in the franchise award being blocked. However, conditional clearance is significantly more likely; merger prohibitions are rare.

Implications for the stakeholders

Stakeholders will be able to comment on the proposed UILs. In the unlikely event that final UILs are not accepted and the review proceeds to Phase 2, stakeholders will be able to participate at various stages as interested third parties.

To ensure continuity, ICRL will operate the ICEC franchise from 1 March 2015, irrespective of the status of the CMA's merger review. However, the CMA may impose interim ("hold-separate") orders for the duration of its review, to prevent integration of businesses or loss of competition on the overlapping Stagecoach rail and bus routes.

As for all franchise mergers, the primary focus of the CMA review is competition issues in transport services; the CMA will not typically address the commercial deliverables of the franchise contract or award. For example, the CMA would not generally challenge plans for e.g. specified rolling stock upgrades, service levels and DfT returns.

Contact us

Our Competition & Sectoral Regulation team works extensively with clients across the regulated industries. We regularly advise on major issues at the intersection of competition law and sectoral regulation.

Please contact us if you have any questions, or to discuss any aspect of this briefing.



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