

October 7, 2015

In March 2013, the Department for Transport announced its new procurement programme for rail franchises. Since then, seven franchises have been awarded, including two by subsidiaries of Transport for London (TfL).

When do the merger rules apply?

The award of a rail franchise may be caught under either the EU or UK merger rules. The application of the EU rules depends on the size of the transaction, as measured by the turnover of both the bidder and the franchise business. If the transaction is sufficiently large, it will be reviewed by the European Commission. Otherwise, the award will be assessed under the UK regime by the Competition and Markets Authority (CMA) (the relevant jurisdictional thresholds are set out below). There is no risk of investigation by both authorities – if the EU merger regime applies, then the UK regime cannot.

At the UK level, the Railways Act 1993 provides that entering into a rail franchise agreement constitutes the acquisition of control of a business and is therefore subject to merger control. This does not extend, however, to the award of a franchise or a concession by TfL, and the CMA can review such awards only if they constitute a relevant merger situation (as defined in the Enterprise Act 2002).

For both of the TfL awards since 2013 (the Docklands Light Railway franchise and the Crossrail concession), the CMA found that the bidder was unable to exercise material influence over the franchise/concession and that therefore a "relevant merger situation" was not created. The European Commission took a similar view in respect of the Docklands Light Railway franchise (where the parties met the relevant EU turnover thresholds) and found that the EU merger rules did not apply.

What are the jurisdictional thresholds?

EU regime

The EU merger rules apply where the group turnover of the bidder and that of the franchise business satisfies either of the turnover tests, shown in the table below. Where the test is met, the bidder must notify the European Commission of the award and receive clearance before operating the franchise. The penalties for not doing so are severe – the parties risk fines of up to 10 per cent of their worldwide turnover.

	EU Turnover Test 1	EU Turnover Test 2

Worldwide turnover threshold: the combined aggregate worldwide turnover of the bidder and its corporate group and the franchise business must exceed:	€5,000 million	€2,500 million
EU turnover threshold: the aggregate EU-wide turnover of each of at least two of the parties must exceed:	€250 million	€100 million AND the combined aggregate turnover of all the parties in at least three EU Member States must exceed €100 million AND in each of three of those same EU Member States, the aggregate turnover of each of at least two parties must exceed €25 million

The above turnover tests are subject to the "two-thirds rule": where all the parties achieve more than two-thirds of their EU-wide turnover in the UK (or another Member State), the UK merger regime will apply rather than the EU rules.

UK regime

The CMA may review the award of a franchise under the UK merger rules, provided that either:

- (a) the UK turnover of the franchise business exceeds £70 million; or
- (b) the award results in the bidder supplying at least 25 per cent of passenger rail services in the UK (or a substantial part of the UK – in practice, this can be a relatively small part of the rail network).

Unlike the EU regime, in the UK, parties are not required to notify transactions to the CMA where either (a) or (b) above is met. However, if they do not do so, the CMA can investigate the award on its own initiative and ultimately unwind a franchise agreement if it is found to result in a substantial lessening of competition (SLC) in the UK.

Competitive assessment

The European Commission can block the award of a franchise if it significantly impedes competition. The CMA can prohibit the award if it may result in an SLC within any market(s) in the UK. In both cases, it may be possible for the award to be cleared subject to the parties giving undertakings to mitigate the identified negative effects on competition.

In assessing whether a franchise may have a negative effect on competition, bidders will need to analyse the extent to which their activities overlap with those of the franchise business, including an individual assessment of competition on individual point-to-point flows ("competition in the market"). The focus of the assessment will be rail-on-rail overlaps, but it will also need to consider rail-on-bus overlaps and rail-on-coach overlaps if the bidder operates these (or other) modes of transport. Whether the overlapping services do in fact compete will depend on a detailed analysis of factors such as journey time and fares for each flow. Account will also need to be taken of third parties that may also compete on these flows (for example, underground, tram, aeroplane).

It should also be mentioned that the authorities' competitive assessment will also consider "competition for the market", that is competition for rail franchises in the UK.

Bidders will need to carry out their own competitive assessment at an early stage in the award process, given that the

invitations to tender (and to pre-qualify) will require bidders to highlight any competition issues and demonstrate how these will be addressed to ensure there is no delay to the procurement process.

Impact on the timetable

Under the EU merger rules, Phase 1 clearance takes at least 25 working days from the date of notification. Generally speaking, the Commission will not enter into pre-notification discussions with the parties until the preferred bidder has been selected, although the Commission has been more flexible recently.

At the UK level, the CMA encourages bidders to enter into pre-notification discussions shortly after submitting their bids (four-six weeks prior to the expected award date). Ideally, at this time, bidders should also consider possible undertakings in lieu of a Phase 2 investigation. Although the CMA will formally investigate only the winning bid, pre-notification discussions with all bidders allow the investigation timetable to start as soon as the winning bidder is selected.

The CMA has 40 working days from acceptance of the winning bidder's notification to announce its Phase 1 decision. In the event the CMA identifies an SLC, there will be an additional period in which to agree undertakings with the parties to deal with the competition concerns. In the recent case of the InterCity East Coast franchise, the period between notification by the parties and acceptance of undertakings by the CMA was around 6.5 months.

As already mentioned, it is possible that bidders for rail franchises will also meet the EU jurisdictional thresholds. In such a case, it is likely that the matter will be referred back to the CMA for consideration under the UK merger rules (which happened with the Thameslink, Southern and Great Northern franchise award to Govia). The CMA is keen for this to happen since rail franchises concern only the UK, and the European Commission may not be able to impose remedies in the way that the CMA could. The referral-back process adds an additional period to the timetable for clearance.

The key message for all bidders is that merger control must form part of any initial assessment¹ the short timetable between announcing the winning bid and commencing operations means that bidders need to consider possible competition issues at the very beginning of the procurement process.

This article was originally published by Rail Professional.

Your Key Contacts



Rebecca Owen-Howes

Counsel, London

D +44 20 7246 7523

M +44 7733 307375

rebecca.owen-howes@dentons.com