

STAYING ON THE RIGHT SIDE OF THE MERGER LAWS

As the competition for rail franchises intensifies, Gillian Sproul explains why bidders must obtain merger clearance

Under the 1993 Railways Act, the award of a new franchise and the transfer to the new franchisee of the assets of the incumbent franchisee count as a transfer of the control of a business and therefore as a merger. Even if the incumbent franchisee wins the franchise for a further term there will be a need for clearance under the 1993 Act.

WHEN WILL MERGER CONTROL BE AN ISSUE?

Any merger that takes place in the UK can be subject to either the EC merger regime, if it is of sufficient size, or, if not, the UK merger regime, as long as it meets the jurisdictional tests in the Enterprise Act 2002. Where the EC regime applies, the UK regime cannot be applied, so there is no risk of an investigation by both the European Commission and the UK Office of Fair Trading/Competition Commission. Other merger regimes may also be relevant, depending on the activities of the business being transferred, but this will be unlikely where the only business being transferred is the franchise business.

THE EC REGIME

The EC regime applies where the turnover of the bidder and the franchise business in their last complete financial year both satisfy one of the two alternative sets of turnover tests, set out in the EC Merger Regulation. These tests enable the bidder to establish relatively easily which

jurisdiction will apply. They are shown in the table.

The two-thirds rule mentioned in the last row of the table is important. Irrespective of the size of its worldwide and EC-wide turnover, where the bidder achieved more than two-thirds of its EU-wide turnover in the UK, the UK and not the EU regime will apply – as long as the UK tests are met.

These rules are complex and need to be treated with care, especially in the case of joint ventures that bid for franchises – the turnover of each joint venture party and its corporate group needs to be considered separately. This explains why the recent acquisitions by the FirstGroup/Keolis and Serco/Nedrailways joint ventures of the Transpennine and Northern franchises were investigated – and cleared – by the European Commission. Not only were the

worldwide and EU-wide turnover thresholds met, but also neither Keolis nor Nedrailways achieved more than two-thirds of their EU-wide turnover in the UK.

THE UK REGIME

The UK regime will apply either where the turnover of the franchise business exceeded £70m in its last complete financial year, or where its share of the supply of passenger rail services in the UK or any part of it was 25 per cent or more.

Under the UK regime, there is no need to obtain merger clearance before taking over the franchise. Where there are significant competition issues, however, it is generally advisable, since the OFT can investigate the acquisition on its own initiative, and the acquisition can be unwound if it is found to result in a substantial lessening of

| | EC TURNOVER TEST 1 | EC 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 |
| Two-thirds rule: if all the parties individually achieve more than two-thirds of their EU-wide turnover in one and the same Member State, that Member State, and not the Commission, will have jurisdiction | EC regime applies | EC regime applies |



The First Group/Keolis winning bid for TransPennine was investigated – and cleared – by the European Commission.

competition in the UK. The bidder can obtain either formal or confidential guidance from the OFT on this issue at an early stage. (Confidential guidance is less reliable, since the OFT cannot consult publicly on the acquisition and could alter its views at a later stage.)

IMPACT OF EC REGIME ON TIMETABLE

Under the EC merger regime, the bidder has no choice but to notify the acquisition and obtain clearance before it can take over the franchise. Since the bidder can be fined up to 10 per cent of its worldwide turnover for these requirements, timing is crucial.

One difficulty is the timing of EC clearance. The European Commission will not accept a notification until the bidder has been selected as preferred bidder, and EC clearance takes at least 25 working days from the date of the notification. This is a disadvantage for bidders whose bids are covered by the EU regime. Bidders subject to the UK regime can seek guidance from the OFT as soon as they establish an intention to bid for the franchise. They do not have to wait for preferred bidder stage to ascertain their chances of obtaining merger clearance. If they seek confidential guidance, this can be provided more promptly than formal guidance. Where the terms of a franchise auction require bidders to have discussed or resolved competition issues with the relevant competition authorities before moving to preferred bidder stage, this discrimination between bidders is particularly problematic. The bidder subject to the EC regime needs to discuss it with the body holding the auction.

'To decide whether there is any risk of being prevented from taking over the franchise, the bidder will need to analyse in some detail the extent to which its activities overlap with those of the franchise business... this can be a complex and time-consuming task'

The timetable for merger clearance can be further extended in cases where an acquisition affects distinct local markets in the UK. The recent decisions on the acquisitions of the Transpennine and Northern franchises confirm that the Commission considers the markets affected by transfers of passenger rail franchises to be distinct local markets, comprising passenger transport services on individual point-to-point flows. During its investigation, the European Commission has the power to grant an application by the UK government to refer the bid to the UK authorities – it has an extra 10 days to consider this. This means the bidder for any UK passenger rail franchise faces the risk of the acquisition being investigated first by the European Commission and then by the OFT, for at least a further month. This significantly extends the timetable for clearance. The bidder can use new provisions in the EC Merger Regulation to ask the European Commission to refer the acquisition to the UK, immediately after being selected as preferred

bidder and before making a notification. But this process still takes around two to three weeks.

WILL THE ACQUISITION BE BLOCKED OR CLEARED?

The procedural issues above should not distract the bidder from assessing at an early stage the risks of the acquisition being blocked. If the EC regime applies, the European Commission can block the acquisition if it will significantly impede competition in the common market, or a substantial part of it, particularly if it creates or strengthens market dominance. If the UK regime applies, the OFT will refer the acquisition to the UK Competition Commission (CC) if it may substantially lessen competition in the UK or any part of it, and the CC has the power to block it. To decide whether there is any risk of being prevented from taking over the franchise, the bidder will need to analyse in some detail the extent to which its activities overlap with those of the franchise business, looking at competition on each of the point-to-point flows within the franchise area. This can be a complex and time-consuming task and requires a review not only of rail services, but also of other modes of transport, particularly where the bidder operates other types of service on the same routes, for example, bus and coach services. Only after this analysis has been done, can the bidder assess the risk of the acquisition being blocked and develop a case to present to the authorities.

All of this means merger control issues need to be the subject of careful planning and early consideration – to avoid difficulties later on.

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