



**Railway Investments Limited and
Marcroft Holdings Limited**

Completed acquisition by Railway Investments Limited
of Marcroft Holdings Limited

12 September 2006

© Competition Commission 2006

Web site: www.competition-commission.org.uk

Members of the Competition Commission who conducted this inquiry

Jeremy Seddon (*Chairman of the Group*)

Peter Jones

Jeremy Peat

Richard Taylor

Chief Executive and Secretary of the Competition Commission

Martin Stanley

The Competition Commission has excluded from this report information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

Completed acquisition by Railway Investments Limited of Marcroft Holdings Limited

Contents

	<i>Page</i>
Summary.....	3
Findings	8
1. The reference.....	8
2. The companies.....	8
EWS.....	8
Marcroft.....	9
3. The merger and the relevant merger situation	10
Outline of merger situation	10
The rationale for the merger.....	11
Jurisdiction	11
4. The haulage and wagon maintenance markets	12
Development of the haulage market	12
Rail freight maintenance	13
Where maintenance is carried out	14
Maintenance companies	14
Customers of rail freight maintenance providers.....	16
Leasing companies	16
Haulage companies.....	16
Companies which transport goods for their own purposes	17
Maintenance costs	18
Regulation of the rail freight industry.....	19
ORR Competition Act investigations involving EWS	19
The Railways Infrastructure (Access and Management) Regulations.....	19
5. Market definition.....	20
The product market	20
Separate markets or a single market?	21
Conclusion: separate markets or single market?	22
The position of in-house maintenance in the product market.....	23
Product definition: other considerations	26
Passenger carriage maintenance.....	26
Specialist maintenance services	27
Additional related product markets.....	28
Conclusions on the product market.....	29
Geographic market definition	29
Conclusions on the geographic market.....	30
The haulage market	30
Conclusions on the market definition	30
6. Counterfactual.....	31
Marcroft's situation in August 2005	31
The alternatives to an acquisition by EWS.....	32
Conclusion on the counterfactual.....	35
What EWS would have done if it had not acquired Marcroft	35
7. Assessment of the competitive effects of the merger.....	36
Market concentration and entry/exit	36
Pricing, profitability and other conduct issues	37
Pricing	37
Profitability.....	38
Customer relationships.....	38

	Tendering	38
	Switching	38
	Criteria for contract awards	39
	Effects of the merger	40
	Marcroft's pre-merger position in the wagon maintenance market	40
	Market power.....	41
	Effects of the merger in the wagon maintenance market	51
	Effects of the merger in the haulage market	54
	Market entry/expansion	64
	The attractiveness of entry into the market	64
	Barriers to entry or expansion	65
	Likelihood of entry or expansion.....	70
	Conclusion on entry/expansion	70
	Countervailing buyer power	70
	Conclusions on the SLC test.....	72
8.	Remedies	72
	Remedy options	73
	Behavioural remedies.....	73
	Divestiture remedies.....	75
	Relevant customer benefits.....	85
	Decisions on the Statutory Questions	86
	Conclusion on remedies.....	86

Appendices:

- A Terms of reference and conduct of the inquiry
- B The companies' financial performance
- C Types of rail freight wagon maintenance
- D Details of ORR Competition Act investigations involving EWS
- E The counterfactual
- F Barriers to entry and expansion
- G The potential for future entry
- H EWS's initial and modified divestiture proposals

Glossary

Summary

1. On 6 February 2006 the Office of Fair Trading (OFT), in exercise of its duty under section 22 of the Enterprise Act 2002 (the Act), referred to the Competition Commission (CC) for investigation and report the completed acquisition by Railway Investments Limited (a wholly-owned subsidiary of English Welsh & Scottish Railway Holdings Limited (EWS)) of Marcroft Holdings Limited, including its wholly-owned subsidiary, Marcroft Engineering Limited (together Marcroft unless otherwise specified). Our terms of reference are in Appendix A. On 19 July the CC decided that, under section 39(3) of the Act, the reference period should be extended by eight weeks. We are required to report by 18 September 2006.
2. EWS is the largest operator of rail freight haulage (haulage) services in Great Britain and through the Channel Tunnel, with a fleet of over 12,000 wagons and over 60 per cent of the haulage market.
3. Marcroft is the largest supplier of third party rail freight wagon maintenance (wagon maintenance) services in Great Britain. It operates a workshop in Stoke-on-Trent and maintains rail freight wagons at a mix of manned and unmanned outstations.
4. On 1 February 2006, EWS purchased Marcroft. The acquisition was a relevant merger situation over which we have jurisdiction.
5. We concluded that the relevant product market in which Marcroft operated was that of wagon maintenance. We considered whether the in-house provision of rail freight wagon maintenance services exercised a competitive constraint on third-party supply, and was therefore in the same market. We concluded that it did not, noting the lack of customers who considered in-house providers to be possible sources of third-party maintenance services and the lack of interest or capability from in-house suppliers in expanding into the third-party market. We concluded that the relevant geographic market was Great Britain.
6. We concluded that the relevant market in which EWS conducted its haulage activities was the supply of haulage services, but we found that our conclusions on the competitive effects of the merger were not changed if EWS's activities were considered as being in several separate markets (for example, for coal haulage, aggregates haulage).
7. Haulage has suffered from a severe decline over the last 40 years, and while there has been some growth in the last ten years, we considered that future growth was likely to be limited, and that growth in the wagon maintenance sector would be less than growth in haulage over the short to medium term.
8. Wagon maintenance companies tend to have established relationships with customers, and we found little evidence of switching by customers between maintenance providers.
9. In considering the effects of the merger, we focused first on whether the merger would have any adverse effects on the wagon maintenance market, and then on any effects in the haulage market.
10. In the wagon maintenance market, prior to the merger EWS had only two small contracts for maintaining third party wagons, and hence the increase in market share caused by the merger was only 1 per cent by revenue. We did not think that this

represented a significant increase in market power in the rail freight wagon maintenance market.

11. We therefore concluded that the merger did not give rise to a substantial lessening of competition (SLC) in the wagon maintenance market.
12. We then considered the effects of the merger in the haulage market. We looked at whether, prior to the merger, Marcroft had had a degree of market power in the wagon maintenance market. We looked at market shares as an indication of market power. We found that Marcroft's large market share strongly suggested to us that Marcroft had a degree of market power, and identified no other factors which affected materially its ability to exercise the degree of market power which its market share might be expected to bring. In reaching this finding we considered both factors set out in our guidelines and information and arguments put forward by EWS. We then considered other factors relevant to this case, and concluded that EWS's main competitors in the haulage market required national coverage, that there were only two companies that could provide this service, and that for two of EWS's main competitors only one company, Marcroft, could provide wagon maintenance services to the level of satisfaction they required. Taking all this evidence together we concluded that Marcroft did have a degree of market power prior to the merger. We considered that bringing Marcroft under EWS's ownership would give it the financial stability it lacked, and management better able to exploit the degree of market power it enjoyed.
13. We considered whether the merged entity had the ability to lower service quality (whilst continuing to meet all safety requirements) and raise prices to EWS's main competitors in the rail freight haulage market.
14. As we had concluded that Marcroft had a degree of market power we concluded that the merged entity could lower service quality (whilst continuing to meet all safety requirements), as EWS's main competitors had insufficient alternatives to Marcroft for carrying out their wagon maintenance. We further concluded that the merged entity would also have the ability to bid at higher rates for tenders (or to seek higher prices from existing customers) than would have been the case in the absence of the merger.
15. We then considered whether the merged entity had the incentive to lower service quality and raise prices to EWS's main competitors in the haulage market. On incentives to lower service quality, we concluded that the merger created a new incentive on EWS to lower Marcroft's service quality offer, at least to certain customers. Before the merger, Marcroft, like all maintenance providers, had the incentive to operate to a service quality level such that it did not lose work due to poor service quality. After the merger, however, lengthening the amount of time taken to maintain a wagon, or respond to a maintenance need, would have the effect of increasing the downtime of the wagons of customers who were EWS's competitors in rail freight haulage. This could result in reducing profits and quality of operations for EWS's competitors at no more cost to the merged entity. There would therefore be an incentive for the merged entity to lower the service quality standard in certain circumstances.
16. On incentives to raise prices, we considered the example of a haulage customer which is a competitor of EWS and for which Marcroft is the incumbent maintenance provider. Following the merger, Marcroft would have an incentive to try to increase the price that it charged that customer for maintenance services. If the customer accepted Marcroft's higher price, then this would result in higher maintenance costs for EWS's competitor in the haulage market, thereby reducing that competitor's

competitiveness. If, however, the customer wished to avoid paying the higher price requested by Marcroft, it would have to choose an alternative maintenance provider which would be charging higher prices, or offering a lower service quality, compared with the package offered by Marcroft prior to the merger. Again, this would increase the costs of EWS's competitor in the haulage market, thereby reducing that competitor's competitiveness.

17. This would mean that the merged entity would be pricing at a level at which it might expect to lose some market share in a small market (wagon maintenance). It would be doing this in order to protect or gain market share in the far larger haulage market, or raise prices in that market, to the benefit of EWS as a whole. We believed, therefore, that the merger created an incentive for EWS to increase the price of Marcroft's maintenance offer to EWS's main competitors in the rail freight haulage market. EWS's main competitors, faced with increased prices, would have to either absorb the price rise and reduce their margins, or pass it on to customers and reduce their competitiveness.
18. We concluded that EWS's competitors in the haulage market (which is worth around £800 million a year) would be faced with higher costs—for example, through having fewer available wagons to do work at any given time, or not being able to run a timetabled train—which might result in financial penalties for missing delivery deadlines. Poor wagon availability could also result in EWS's rivals losing work, as contracts for haulage of consumer goods could be lost very quickly if performance standards were not met.
19. We concluded that EWS had the ability and incentive to lower service quality and/or raise prices to its main competitors in the haulage market, and that it may be expected to follow this course of action. We concluded that this gave rise to an SLC.
20. We considered whether actual or potential market entry would offset the SLC identified. However, we concluded that entry into the rail freight wagon maintenance market is unattractive, and that there would need to be significant changes to render it more attractive, such as a significant increase in margins for maintenance providers. Further, even if a company sought to enter the market on any scale, there were significant barriers to entry which would render such entry difficult.
21. We also considered if countervailing buyer power would offset the SLC identified. We concluded that there would be significant risks for EWS's competitors moving their maintenance arrangements, particularly to any of the small maintenance providers, because of the uncertainty as to whether any of those small maintenance providers could successfully expand rapidly enough to take on the whole of a contract. This would constrain the ability of EWS's main competitors to exercise any degree of buyer power they might otherwise have.
22. EWS submitted arguments on how it had neither the ability nor incentive to raise prices or lower service quality after the merger. These included: that raising downstream competitors' costs by a material amount would involve an implausibly large increase in maintenance prices; that the merged entity was effectively constrained by competitors, potential entrants and customers moving to self-supply of wagon maintenance; and that such actions would be disproportionately damaging to EWS's reputation. We considered these arguments, and all other arguments put to us by EWS, carefully. However, in light of the factors outlined above, we did not find these arguments convincing.
23. We concluded, therefore, that the merger gave EWS the ability and incentive to lower service quality and/or raise prices to its competitors in the haulage market. We

conclude that this is an SLC arising from the merger. We conclude that the SLC may be expected to result in lower service quality and/or higher prices for wagon maintenance services provided to EWS's competitors in the haulage market, and in turn to lower quality service and/or higher prices for end-users.

24. On the question of remedies, we considered behavioural remedies outlined by EWS, and three possible divestiture packages: divestiture of the whole Marcroft business, divestiture of the outstation business (allowing EWS to retain the Stoke workshop), and divestiture of part of the outstation business. On the last of these we considered proposals for a partial divestiture put forward by EWS.
25. On behavioural remedies, EWS suggested the appointment of independent non-executive members to the EWS Board, or the creation of a supervisory board, as possible ways of remedying any SLC found. We did not consider that a behavioural undertaking of the type outlined by EWS would be effective and practical in remedying the SLC and adverse effects. We believed that: such a structure could not respond quickly enough to prevent significant damage, which could be inflicted over a very short timescale; that it would be extremely difficult to specify and observe the outputs to be controlled and monitored; that it would be very hard for such a structure to distinguish effectively and unequivocally between normal commercial prioritization and decisions taken to disadvantage a competitor; and that such a structure would be unable to react quickly enough to prevent damage to competitors.
26. We then turned to consider divestiture remedies. We concluded that divestiture of the Stoke workshop was not necessary to remedy the SLC and adverse effects identified, and that requiring it to be sold with the outstation business might actually increase the risk of not finding a purchaser for the divested business, or of the divested business not being viable in the longer term.
27. We concluded that requiring EWS to dispose of the whole of Marcroft's outstation business would provide a comprehensive solution to the SLC and adverse effects identified.
28. We concluded that the disposal of a part of the Marcroft outstation business could be a suitable remedy if the package was sufficient to remedy the SLC and create a viable independent competitor offering nationwide coverage, and that adequate safeguards relating to the disposal were put in place. EWS offered three partial divestiture proposals. On the first two of these we were unable to conclude that the packages as proposed by EWS would remedy satisfactorily the SLC and adverse effects identified. EWS told us that it had identified a potential purchaser that was prepared to enter into discussions with a view to acquiring the divested package set out in EWS's final divestiture proposal, subject to due diligence. We considered that EWS's final divestiture proposal, if agreement on it were reached with the potential purchaser, should remedy the SLC and adverse effects identified if certain risks were overcome. These included: that all the larger customers identified were prepared to switch to the potential purchaser, for their wagon maintenance; that due diligence was completed and contract terms negotiated successfully; that agreement on a purchase price was reached; and that we were provided with business plans for the divested entity so that we could be satisfied that the divested entity would be able to act as an effective and financially viable competitor in the wagon maintenance market, offering national coverage.
29. We conclude that EWS should be required to seek to give effect to its final divestiture proposal (or something broadly similar to it) with the potential purchaser it has identified, and that if it is unable to do so within the initial divestiture period, EWS should be required to invite offers for the disposal of the whole or part of the Marcroft

outstation business. Any partial divestiture package is to be subject to approval by the CC to ensure it satisfactorily addresses the SLC and adverse effects identified, and would not be subject to significant risks.

Findings

1. The reference

- 1.1 On 6 February 2006, the OFT, in exercise of its duty under section 22 of the Act, referred to the CC for investigation and report the completed acquisition by Railway Investments Limited (a wholly-owned subsidiary of EWS) of Marcroft. Following an extension to the original inquiry period ending on 24 July, we are required to report by 18 September 2006. Our terms of reference are in Appendix A.
- 1.2 This document (together with its appendices) constitutes the report that we are required to publish under section 38 of the Act. Non-sensitive versions of the main-party and third party submissions are on our website, along with other documents relevant to this inquiry. We refer to them where appropriate.

2. The companies

EWS

- 2.1 EWS developed out of the privatization of British Rail. In December 1995, a consortium led by Wisconsin Central International Inc acquired, through its UK holding company North & South Railways Ltd, Rail Express Systems, which operated the Royal Mail's travelling sorting offices. In February 1996, the same holding company bid successfully for the three rail non-intermodal¹ freight companies created out of British Rail. Soon afterwards it changed its name to EWS. In 1997, EWS acquired Railfreight Distribution, the long-distance Channel Tunnel freight service, and in April 1998, it acquired National Power's freight operation. In 2001, Wisconsin Central, EWS's principal shareholder, was acquired by Canadian National Railway.
- 2.2 EWS is now the largest provider of haulage services in Great Britain and through the Channel Tunnel, with a fleet of over 12,000 wagons² and over 60 per cent of the haulage market (see Table 3). EWS divides its activities into the following business units through different subsidiaries: haulage; rail industry services; rail passenger charter services; and non-freight operations. EWS's recent financial performance is described in Appendix B, paragraphs 14 to 18. In the year ended March 2005, it generated a profit before tax of £35.0 million on turnover of £497.5 million (see Appendix B, Table 6).
- 2.3 EWS's contracting engineering section has recently been rebranded Axiom Rail. Axiom Rail encompasses the commercial maintenance services business of EWS and includes the supply of bogies, passenger train refurbishment, maintenance of locomotives, leasing of locomotives and maintenance in the field of wagons (EWS carries out wagon maintenance for two third parties as well as maintaining its own fleet).³ EWS told us that Axiom Rail does not actively target freight wagon maintenance due to EWS's high cost base.
- 2.4 EWS carries out its own wagon maintenance. All its maintenance is carried out in the field (see paragraphs 4.9 and 4.10 for the types of maintenance carried out). It does not own a workshop for servicing wagons, and contracts out its component overhaul

¹Intermodal refers to the transport of goods by more than one means of transport and usually refers to container shipments.

²EWS main submission to the CC, Table D. In August 2006 EWS provided us with an updated version of this table, which showed that EWS at that time had a fleet of 11,200 wagons.

³EWS main submission to the CC, paragraph 7.37.

requirements (see paragraph 5.31), primarily to Wabtec Rail Ltd (Wabtec). As a result of the merger, EWS will gain access to a workshop where it can carry out its own component overhaul requirements.

2.5 As noted in paragraph 2.3, EWS also has two small contracts to provide wagon maintenance services to third parties, as parts of larger contracts for haulage services. EWS told us that the maintenance elements of these two contracts together covered only 174 wagons⁴ and produced revenue of less than £[redacted] a year in 2004/05.

2.6 The shareholders in EWS are:

- Wisconsin Central International Inc (31.6 per cent);
- Fay, Richwhite UK Management Ltd, Auckland, New Zealand (16.6 per cent);
- UK Railway Holdings (BVI) Ltd (13.7 per cent);
- Berkshire Fund IV, LP Boston, Massachusetts, USA (10.4 per cent);
- EW&S Trustees Ltd (8.4 per cent);
- The Goldman Sachs Group, Inc (5.7 per cent);
- Berkshire Fund III, LP Boston, Massachusetts, USA (5.6 per cent);
- Nassau Capital Partners LP, Princeton, New Jersey, USA (4.7 per cent); and
- others (2.9 per cent).

Marcroft

2.7 Marcroft's business has been carried on in Stoke-on-Trent since 1947. Its recent history has included several transfers of ownership. In February 2004, it was bought from CAIB Rail Holdings Ltd, a subsidiary of VTG-Lehnkering AG (VTG-Lehnkering) by a management buyout (MBO) team. As part of the acquisition, Marcroft was granted a [redacted] contract to provide wagon maintenance services for VTG Rail UK Ltd (VTG), also a subsidiary of VTG-Lehnkering (see paragraph 4.22) and a lessor of wagons in the UK.

2.8 Marcroft has a central workshop facility and offices in Stoke-on-Trent, and has access to 24 permanently-manned outstations (designated by its customers) and 72 unmanned maintenance sites (serviced through mobile service teams), where it carries out maintenance in the field. It currently maintains over 3,800⁵ wagons. Its main customer (accounting for over [redacted] per cent of the wagons it maintains) is VTG, almost all of whose wagons it maintains. Its next most important customers are GE Rail Services (GE Rail) (see paragraph 4.23) and Freightliner Group Ltd (Freightliner) (see paragraph 4.25).

⁴EWS main submission to the CC, Table D.

⁵EWS main submission to the CC, Table D. In August 2006 EWS provided us with an updated version of this table, which showed that Marcroft maintained over 3,700 wagons.

2.9 Marcroft's recent financial performance is described in Appendix B, paragraphs 1 to 13. In the year to December 2004, Marcroft generated a loss before tax of £1.5 million on turnover of £12.7 million (see Appendix B, Table 3).

2.10 The shareholders in Marcroft Holdings Ltd immediately prior to the merger are set out in Table 1.

TABLE 1 Marcroft Holdings Ltd shareholders prior to merger

Owner	Position	Share type		
		Ordinary	Preferred ordinary	Preference
Peter Opperman	Venture capitalist	Nil	3,500	Nil
Guy Opperman	Venture capitalist's brother	Nil	250	Nil
Alan Matthews	Finance Director	1,000	250	20,000
Robert McNeil	Managing director	2,000	Nil	15,000
HSDL Nominees Ltd*		Nil	Nil	25,000
Richard Simons	Field services Director	750	Nil	15,000
Ian Wicks	Engineering Director	1,000	Nil	20,000
Christopher Kettle	MBO adviser	500	Nil	10,000
James Macfadyen	Chairman	<u>1,250</u>	<u>Nil</u>	<u>25,000</u>
Total		6,500	4,000	130,000
Issued share capital (£)		65	40	130,000

Source: EWS, Marcroft statutory accounts 2004.

*HSDL Nominees Ltd holds these preference shares for Robert McNeil.

2.11 The Preference Shares were redeemable from March 2008 subject to the repayment of £399,960 secured loan notes having been completed and there being no arrears of dividend on the Preferred Ordinary Shares. This gave the holders of the secured loan notes and Preferred Ordinary Shares priority over the holders of Preference Shares.

3. The merger and the relevant merger situation

Outline of merger situation

3.1 In July 2005, Marcroft's advisers circulated an information memorandum, inviting bids for Marcroft. Five companies were sent the memorandum: EWS, London and North Western Railway Company Ltd (LNWR), Railpart (UK) Ltd, Turner Diesel Ltd, and Wabtec. Only EWS responded positively (though Wabtec expressed an interest in acquiring only the outstation business of Marcroft). On 4 August 2005, EWS made an offer for the business which resulted in Marcroft granting EWS exclusivity, and EWS started due diligence.

3.2 On 4 November 2005, EWS announced that it had agreed to purchase the entire share capital of Marcroft. The consideration was approximately £[redacted]. The merger was completed on 1 February 2006. The net purchase price payable at completion was £[redacted], with a further £[redacted] to be paid unless the CC were to determine that any action whatsoever should be taken under section 35(3) of the Act. A further £[redacted] is held as a warranty retention, so that the maximum purchase price is £[redacted] in addition to the assumption of debt of £[redacted].

The rationale for the merger

3.3 EWS told us that the acquisition of Marcroft was an opportunistic action. It told us⁶ that there were three main reasons for acquiring Marcroft:

- [X] It told us that, by acquiring Marcroft and continuing to run it as a stand-alone business trading with customers in the same manner as is currently the case, EWS [X] compete in the provision of light in-field⁷ (and other) wagon maintenance services to third party customers;
- *To deliver synergies in terms of central costs.* This, together with the additional work referred to above, would make the Marcroft business more profitable. In a presentation to the EWS Board on the proposed acquisition, these were set out as: [X], insurance of Marcroft's Stoke site, EWS support functions, and increased leverage on suppliers.
- *To make better use of the Stoke workshop.* EWS told us in its main submission that it saw opportunities to increase the utilization of the Stoke workshop by overhauling its own wagon components there, and by expanding into the market for the provision of rail passenger carriage overhaul and refurbishment services.

3.4 In addition to these benefits, in a presentation to the EWS board on the proposed acquisition, EWS stated that the acquisition would offer it opportunities to grow in passenger carriage component overhaul, and passenger carriage heavy repairs, that the Marcroft business complemented the Axiom Rail business dealing with suspension units, and [X]. EWS also stated, in a board paper that, should the CC require divestiture of the business, it was likely to be able to improve the business and sell it on at a profit.⁸

Jurisdiction

3.5 Under our terms of reference (see Appendix A), we are required to investigate and report on whether a relevant merger situation has been created. A relevant merger situation exists where two or more enterprises have ceased to be distinct and where the share of supply test or the turnover test specified in the Act is satisfied.

3.6 As a result of the transaction described in paragraph 3.2, EWS and Marcroft have ceased to be distinct enterprises.

3.7 The share of supply test is satisfied if the merger creates or increases a share of at least one-quarter in the supply of goods or services of any description in the UK, or in a substantial part of the UK. We consider here the supply of light in-field wagon maintenance services in Great Britain. Further, we consider the total supply of these services (that is including in-house provision) and the supply of these services by third parties alone.

⁶EWS main submission to the CC, paragraph 3.7.

⁷This is commonly referred to as 'in-field maintenance' in the industry. We refer to it as 'Light in-field maintenance' here to distinguish it from other forms of maintenance carried out in the field. See Appendix C for the different types of wagon maintenance carried out.

⁸EWS told us that making the level of improvement to the Marcroft business envisaged in this board paper had not been possible given the effect of the Interim Undertakings signed on 13 March (see Appendix A, paragraph 2).

- 3.8 EWS estimated⁹ that it currently had 59.5 per cent of the whole market for light in-field wagon maintenance services, and that Marcroft had 18.6 per cent of the same market. If the market was restricted to provision of these services to third parties, EWS estimated that Marcroft currently had 55.8 per cent of the market, and EWS 2.5 per cent. In both cases, adding Marcroft's share of supply to that of EWS results in an increment to a greater than one-quarter share of supply in Great Britain.
- 3.9 Since the share of supply test is satisfied we are not required to consider the turnover test.
- 3.10 We therefore find that the acquisition of Marcroft by EWS resulted in the creation of a relevant merger situation.

4. The haulage and wagon maintenance markets

Development of the haulage market

- 4.1 Haulage of freight is carried out by road, by rail, by sea and by pipeline. Rail freight accounted for around 11.5 per cent of goods transported in the UK in 2004; the majority of goods (around two-thirds) were transported by road.
- 4.2 Until the mid-1990s, there had been a steady decline in the amount of goods hauled by rail. For example in 1952, 37 billion tonne kilometres (btkm) of freight was hauled by rail. By 1995, this had reduced to 13 btkm. More recently, however, the volumes hauled by rail have increased—by 55 per cent between privatization in 1997 and 2005 on a tonne kilometre basis. In 2004, rail shipments amounted to some 20.6 btkm.
- 4.3 At the same time the number of wagons has reduced significantly. Table 2 shows a comparison of number of wagons and wagon utilization between 1963 and 2004. Wagon numbers have reduced from around 850,000 to 21,000. However, the amount of freight moved has only reduced from 25 to 21 btkm over the same period. Modern wagons carry more weight (an increase in average load from 8 tonnes to around 50) and are utilized more (around 120 movements a year compared with 37). There has been significant investment in new wagons since the mid-1990s, which has increased load sizes and resulted in new wagons which require less maintenance.

TABLE 2 **Wagon efficiency**

	1963	2004
Total movements btkm	25	20.6
Wagons '000	848	21
T* km/wagon '000	29	981
Ave load, tonne	8	50
Total km '000	3.7	19.6
No. of trips	37	121
Average km per trip	101	162

Source: Beeching report; Freightliner website; Department for Transport integrated transport and economic appraisal, June 2002; CC analysis.

*t = tonnes.

⁹EWS main submission to the CC, Table D. In August 2006 EWS provided us with an updated version of this table. This showed that the first three figures quoted in paragraph 3.8 had changed to 56.7, 18.9 and 53.5 respectively. These changes do not affect our conclusion on jurisdiction.

- 4.4 The total value of the rail freight sector (measured by turnover) was approximately £800 million in 2005. In 2001, the Strategic Rail Authority targeted an 80 per cent growth in rail freight over the following ten years. More recent statements by the Secretary of State for Transport¹⁰ recognized that the 80 per cent forecast was unlikely to be met, but restated the Government's policy aim to move freight from road to rail and set out a number of initiatives to help support this. The Rail Freight Users Group is forecasting a 20 per cent growth in haulage between 2005 and 2014. In a June 2005 press release,¹¹ EWS pointed to the 9.5 per cent increase in haulage during 2004/05 and stated its belief that future growth in rail freight is expected to continue by increasing services for bulk haulage, general merchandise and fast moving consumer goods.
- 4.5 However, EWS told us that, in its view, rail freight growth forecasts by the Rail Freight Users Group were overstated [redacted] and that it did not follow that any growth in that sector would lead to corresponding growth in the wagon maintenance market.
- 4.6 We heard nothing during our investigation to make us doubt that the haulage sector will continue to grow over the next ten years, though the level of growth was open to debate. Some haulage traffic continues to be lost to rail, and some new contracts are awarded (Direct Rail Services (DRS) brought to our attention new consumer goods traffic). On balance it seems likely that the modest growth predictions of the Rail Freight Users Group are realistic, though, given EWS's evidence, they are likely to be an upper bound.
- 4.7 We considered if this would result in a corresponding growth in the need for wagon maintenance services. Marcroft had not prepared any forecasts of the future size of the wagon maintenance market; we received no quantitative evidence on how the growth in haulage would impact on the need for wagon maintenance, and we recognized that the interaction between the two could be complex. As set out in paragraph 4.3, wagons have been used progressively more efficiently. Further, new wagons generally have a higher capacity, and are being built with a view to making maintenance easier to perform. EWS concurred with this, noting an ever-increasing utilization of wagons, better design of wagons and more efficient maintenance practices of wagon owners. We thought, therefore, that the growth in wagon maintenance would be less than the growth in haulage over the short to medium term.

Rail freight maintenance

- 4.8 All wagons require maintenance. Based on EWS and Marcroft turnovers, we estimated that the cost of wagon maintenance was around £[redacted] a year (including maintenance carried out in-house). Of this, around £[redacted] was attributable to third party maintenance.
- 4.9 Wagons require periodic maintenance and overhaul in order to remain serviceable and fit for use on the rail network. There are four main categories of maintenance for wagons:
- light in-field maintenance;
 - general repair (GR) maintenance;

¹⁰Statement to Parliament by the Secretary of State for Transport Alistair Darling on 19 July 2005.

¹¹24 June 2005 press release.

- component-based maintenance (CBM); and
- strip-down and gauging maintenance (SDG), also known as 'balanced maintenance'.

4.10 The various forms of maintenance are described in more detail in Appendix C. Broadly, however, all wagons will require light in-field maintenance for routine maintenance, minor repairs and a vehicle inspection and brake test (VIBT). Vehicles will also undergo one of the other three maintenance regimes for more significant maintenance. Of the three, GR maintenance requires a fully-equipped workshop and involves a full strip-down of the wagon, but CBM and SDG are both performed in the field. Under CBM, components are periodically replaced in accordance with a pre-determined maintenance timescale, while SDG maintenance involves the intermittent gauging and testing of components on a sample of wagons and component replacements where the gauging and testing indicate that this is required. EWS is the only company that uses CBM. Different companies have different preferences: some prefer GR maintenance, as it can be timed to coincide with the end of a wagon's lease, others prefer SDG to keep a wagon in the field as much as possible.

Where maintenance is carried out

- 4.11 Maintenance is carried out in workshops (GR maintenance) and in the field (light in-field maintenance, CBM and SDG). There are some 290 freight maintenance sites in Great Britain registered on the Total Operations Processing System (TOPS) database. Around 92 are controlled by EWS and five by Freightliner. Most of the remainder are situated on customer property. With the exception of Network Rail (23 sites), each customer controls 15 or fewer sites (usually far fewer than 15).¹² The sites controlled by EWS are in many cases owned by Network Rail but leased to EWS on 125-year leases. Marcroft leases six maintenance sites, all from EWS, and has access to another 90 sites (see paragraph 2.8).
- 4.12 EWS told us that it had recently started charging for access to the outstations it controls, in order to recoup its costs in operating its outstations. Marcroft leases five sites from EWS at annual rentals ranging from £[redacted] to £[redacted] a year (it does not pay rent on the sixth site it leases from EWS). Wabtec told us that it had been asked by EWS to pay £7,500 for licences to operate at each of 11 sites controlled by EWS which Wabtec used for a Network Rail contract. Wabtec told us that until May 2005, it had paid a peppercorn rent to use these sites.

Maintenance companies

- 4.13 Apart from Marcroft, there are several companies currently supplying wagon maintenance services in Great Britain. In this section we briefly set out the other wagon maintenance service providers.
- 4.14 Aside from Marcroft, the largest supplier of third party wagon maintenance services is Wabtec. Wabtec has long had a presence in the wagon maintenance sector, and was widely recognized as a competitor to Marcroft by the customers to whom we spoke. Wabtec has recently won the contract to maintain 1,200 wagons for Network Rail (an expanded version of a contract it had previously held). The Network Rail contract is Wabtec's most significant freight-related contract, accounting for around

¹²Note that the owner has not been identified for 43 sites.

50 per cent of the wagons it maintains. It also has maintenance contracts with companies including Lafarge Aggregates Ltd and CEMEX UK Ltd.

- 4.15 Whilst Wabtec is an established provider of wagon services, it told us that it had decided that the amount of workshop-based GR work available was likely to decrease, and as a result it had sought to develop its other core businesses including wheelset, bogie overhaul and components businesses, and to move into the passenger carriage refurbishment market, as well as growing its wagon fleet care business. It has a 30,000 sq metre workshop facility at Doncaster and recently moved successfully into the passenger carriage maintenance sector. Its work in this sector now generates a significantly greater turnover than work in the wagon maintenance sector.¹³
- 4.16 WH Davis Ltd (Davis) is also a long-established supplier of wagon maintenance services. Davis has a 7,500 sq metre workshop based in Mansfield and told us that in addition to wagon maintenance it also builds railway wagons. Davis offers maintenance both in the field and in the workshop. It currently has several maintenance contracts, the largest being with Aggregate Industries. In total, it currently provides light in-field maintenance services for about 330 wagons. It told us that it could offer a national service for maintenance in the field. However, some customers we spoke to told us that they did not think Davis was able to provide a national service, and did not consider Davis to be a viable maintenance provider for their needs on this basis. [REDACTED]
- 4.17 EG Steele & Co Ltd (Steele) also offers maintenance both in the field and in the workshop, with a workshop in Hamilton, Scotland. It told us that several of its customers had exited the rail sector recently. [REDACTED], Channel Commercials plc (Channel Commercials), which will take over a contract Steele has to carry out maintenance on a small fleet of wagons run by Brett Aggregates.¹⁴ Steele told us that it was sponsoring entry because the Brett Aggregates wagons were too far away from its Hamilton base to maintain without great expense. Although it has had contracts that saw it providing service across the country, Steele told us that, while its workshop could take work from anywhere in Great Britain, it could not presently offer light in-field maintenance services on a national basis. However, it subsequently told us that it was tendering for a national contract (operating at a limited number of depots) and said it had the resources to carry out this work.
- 4.18 Bombardier Transportation UK Limited (Bombardier) is primarily a rolling stock manufacturer and after-service provider in the UK, but it does provide light in-field and GR for Esso UK Ltd's fleet of around 300 wagons. It told us that it has provided this service for over ten years. It had also had a contract to maintain wagons for another oil company, but this ended when that oil company stopped transporting oil by rail.¹⁵ Bombardier told us that it did not consider itself active in the wagon maintenance market, and that it was not currently looking to win more work in the wagon sector; this was not a high priority for it given the low margins in wagon maintenance.
- 4.19 Other small providers of wagon maintenance include three recent entrants. Clarke Chapman (which won a contract to maintain some rail delivery trains another company in the Clarke Chapman group was designing and building for Network Rail) [REDACTED]. Channel Commercials, which, as explained in paragraph 4.17, is being assisted

¹³In 2005 Wabtec achieved total transit (passenger) sales of £45.7 million (a threefold increase on its transit sales in 2003) and total freight sales of £12.7 million (half of its freight sales in 2003).

¹⁴Summary of staff hearing EG Steele and Co Ltd, paragraph 14.

¹⁵Summary of a hearing with Bombardier Transportation, paragraph 2.

to enter the sector to take over a specific contract from Steele. Arlington Fleet Services (Arlington), which was set up three years ago, has been specializing in unplanned 'running repair' work such as removing and fitting wheelsets. Arlington, which only generated a turnover of around £200,000 in each of its three years of operation, has not yet won any contracts to carry out routine wagon maintenance.¹⁶

- 4.20 Most of the haulage companies carry out some or all of their own maintenance, but with the exception of EWS do not offer maintenance services to third parties.¹⁷ Freightliner performs its own maintenance on its intermodal fleet (including wagons leased to it) but its Heavy Haul fleet is maintained by Marcroft, and DRS maintains its own fleet of special wagons for transporting spent nuclear fuel whilst its other wagons are maintained by Marcroft. GB Railfreight performs no in-house maintenance.

Customers of rail freight maintenance providers

- 4.21 The customer for wagon maintenance services is, in most cases, the wagon owner. The wagon owner may be a leasing company, a haulage company, or companies which require the transportation of freight for their own business purposes (either as the producer or the user of the freight being transported). In a few instances wagons are leased to a user who is responsible for arranging the wagons' maintenance.

Leasing companies

- 4.22 The major wagon leasing companies are VTG, GE Rail and NACCO (UK) Ltd (NACCO). In 2005 VTG and its German parent company were sold to the Compagnie Européenne de Wagons SA, a Luxembourg company formed for this transaction by the US private equity company WL Ross & Co LLC. VTG owns around 2,000 wagons in the UK, which are leased out to various customers.
- 4.23 GE Rail is a subsidiary of General Electric Company. It owns around [redacted] wagons in the UK. NACCO is the largest privately-held rolling stock lessor in Europe with its main office in Paris. The company has around 300 wagons in the UK.

Haulage companies

- 4.24 In addition to EWS, there are three main haulage companies in the UK: Freightliner, DRS, and GB Railfreight. In addition, there is a smaller specialist company, Mendip Rail.
- 4.25 Freightliner originated from the intermodal business of British Rail. It is the largest supplier of intermodal rail services in the UK. It also entered the bulk freight market through the creation of its Heavy Haul division around 2000. The Heavy Haul division has grown from a turnover of zero in 2000 to £75 million in 2005 [redacted].
- 4.26 Freightliner carries out light in-field maintenance on its intermodal fleet of [redacted] wagons from a base in Southampton. It contracts out GR of its intermodal wagons (it has recently been seeking tenders for the GR of a small portion of its intermodal fleet). Freightliner has contracted out the maintenance of all of its Heavy Haul fleet (of approximately [redacted] wagons) to Marcroft. Freightliner told us that all its intermodal wagons operated on a rigid timetable and regularly circulated through Southampton,

¹⁶Summary of hearing with Arlington Fleet Services, paragraph 1.

¹⁷EWS has two wagon maintenance customers, see paragraph 2.3.

where they could be maintained.¹⁸ However, its Heavy Haul wagons tended to operate on a variety of different routes and therefore could not be timetabled to circulate regularly through one location for maintenance. EWS disputed this, saying that Freightliner's Heavy Haul wagons did operate on fixed routes.

- 4.27 DRS was formed in 1995 out of a business which was previously a wholly-owned subsidiary of British Nuclear Fuels plc. It has been owned by the Nuclear Decommissioning Authority since 1 April 2005. It specialized in transportation of spent nuclear fuel, but diversified into third party haulage, and has won several contracts for transportation of time-critical consumer goods.¹⁹ DRS carries out light in-field maintenance on its own fleet of wagons used for transporting spent nuclear fuel, whilst Marcroft is the maintenance provider for its fleet of AAE Megafret wagons used for its non-nuclear haulage services.
- 4.28 GB Railfreight was formed in 1999 by GB Railways, which was subsequently purchased by FirstGroup in 2003. Its principal business areas cover the transportation of bulk materials, petrochemical products, intermodal traffic and engineering trains in support of track renewal programmes being undertaken for Network Rail and Metronet. The company has recently won an extension to an existing contract with the Royal Mail on whose behalf it operates mail and parcel trains between London and Scotland.
- 4.29 Mendip Rail, owned by Hanson Quarry Products Europe Ltd and Foster Yeoman Ltd, primarily provides a specialist aggregate haulage service for building material companies. It hauls over 6.5 million tonnes of rail freight each year, operating over 290 services a week. Marcroft provides wagon maintenance services for Mendip Rail.
- 4.30 Table 3 shows estimates of the shares of supply in haulage service for the four major haulage companies.

TABLE 3 Freight company market shares (2005)

Company	Overall share of supply (based on revenue)	per cent		
		Coal market	Infrastructure	Intermodal
EWS	(
Freightliner				
DRS			✂	
GB Railfreight				
)			

Source: EWS, Freightliner estimates.

Companies which transport goods for their own purposes

- 4.31 The largest fleet of wagons owned by a company which transports freight for its own purposes is that of Network Rail, which has nearly 1,500 owned wagons (and over 400 wagons which it leases) which it uses for its rail maintenance activities. Most other large wagon fleets are owned by companies transporting heavy bulk materials such as aggregates and oil products. Table 4 shows the ten largest fleets owned by such companies.

¹⁸Summary of hearing with Freightliner, paragraph 7.

¹⁹Summary of a hearing with Direct Rail Services, paragraph 1.

TABLE 4 Largest end-user owned wagon fleets

Company	Fleet size
Network Rail	
Lafarge ²⁰	
Mendip Rail	
Eso UK	
BP Oil	
STVA	
British Alcan	
Cemex	
Plasmor	
WBB Minerals	

Source: Company submissions, EWS.

Maintenance costs

4.32 Table 5 shows the evidence presented to the CC concerning the proportion of wagon operating costs accounted for by wagon maintenance costs, for various parties. We were told that maintenance costs for the wagon leasing companies range from one-quarter to three-quarters (1/4 to 3/4) of the total operating costs for leasing companies. We also noted that, for many leasing companies, financing costs and depreciation can greatly exceed operating costs, so wagon maintenance will be a smaller proportion of total costs. Wagon maintenance costs for freight operators typically represent up to 20 per cent (1/5) of operating costs, and up to 10 per cent for the large haulage companies (1/10). Maintenance costs for haulage customers vary up to 40 per cent (2/5) of operating costs. We do not have any evidence as to why this range is so large, though it may be related to what different companies count as operating costs.

²⁰Note the Lafarge wagon fleet figure is the sum of the fleets of Lafarge Aggregates and Lafarge Cement UK. In practice, these fleets are operated separately.

TABLE 5 Maintenance cost as proportion of operating costs

Company	Proportion of costs
<i>per cent</i>	
Haulage operators:	
EWS	
Freightliner	
Mendip Rail	
Haulage customers:	
Aggregate Industries	
BP	
Corus*	
Tarmac	
Wagon leasing companies:	
GE Rail	
NACCO	
VTG	

Source: Hearings with CC, responses to CC requests for information, and EWS main submission.

*Note that Corus's figure denotes the proportion of its transport costs.

Regulation of the rail freight industry

4.33 The rail industry is regulated by the Office of Rail Regulation (ORR). Haulage is a licensed activity, for which an undertaking has to demonstrate that it is financially and legally sound and has adequate insurance and safety systems in place, but freight operating companies do not operate under exclusive franchises and can compete with each other in all aspects of their business. ORR does not regulate freight light maintenance activities. In this section we briefly cover two aspects of regulation of relevance to this investigation: the ORR's investigations under the Competition Act involving EWS, and The Railways Infrastructure (Access and Management) Regulations 2005 (the 2005 Regulations).²¹

ORR Competition Act investigations involving EWS

4.34 The EC Treaty and the Competition Act 1998 both prohibit conduct by an undertaking which amounts to abuse of a dominant position. The prohibitions are set out in Article 82 of the EC Treaty and section 18 of the Competition Act (the Chapter II prohibition). The OFT is empowered to investigate potential breaches of the Chapter II prohibition. Sectoral regulators have concurrent powers in relation to their respective sectors. The ORR has concurrent powers in relation to the supply of services relating to railways. According to its website, the ORR has, in relation to investigations into possible infringement of the Chapter II prohibition, reached five non-infringement decisions and closed a further three cases to date. Three of these eight completed cases have involved allegations made against EWS. Another investigation involving EWS is ongoing. Details of these investigations can be found in Appendix D.

The Railways Infrastructure (Access and Management) Regulations

4.35 The 2005 Regulations deal with the rights of third parties to gain access to railway infrastructure, including the rail network, stations and tracks. They create a presumption of access and provide the right for an applicant to apply for access to a

²¹The Railways Infrastructure (Access and Management) Regulations 2005 SI 2005 No 3049.

range of services and facilities, including freight terminals and maintenance facilities (irrespective of their exempt status under the Railways Act 1993²²), for the purpose of the operation of certain types of rail services, such as freight services and international passenger services operated by international groupings. The 2005 Regulations came into effect in November 2005. Applicants can apply to the facility operator or service provider for access, with the presumption that, if there is no viable alternative and if there is capacity, the access will be granted. An applicant (which has a wide interpretation under the 2005 Regulations and may, in certain circumstances, include maintenance service providers) has a right of access to a range of facilities and services listed within the 2005 Regulations and may appeal to the ORR should that access be denied on reasonable terms.

- 4.36 If an applicant feels aggrieved because an application has been refused or because of the terms required, it can appeal to the ORR. In March 2006, the ORR produced guidance on appeals under the 2005 Regulations. The ORR states its aim is to facilitate reasonable requests for access while protecting the legitimate commercial interests of the facility owner. ORR will assess an application in accordance with its published criteria and within the framework of rights for access created by the Regulations. ORR's published guidelines include its position on circumstances in which access could be refused or restrictions imposed, assessing viable alternatives and interpreting market conditions. It is not clear whether maintainers are caught by the definition of applicant in all circumstances. Appeals to the ORR are fact dependent and will always be treated on a case-by-case basis. The appeal mechanism has not yet been used.

5. Market definition

- 5.1 This section of our report considers the definition of the market for the purposes of the inquiry. There are normally two dimensions to the definition of a market: the product market and the geographic market. The products that should be included in the relevant market and the geographic boundaries of that market are determined by substitutability, ie the extent to which customers can readily switch between substitute products or suppliers can readily switch their facilities between the supply of alternative products. The generally accepted approach seeks to identify the extent to which customers could readily demand, or suppliers readily supply, adequate substitute products in response to a small but significant non-transitory increase in price (SSNIP)²³ imposed by a hypothetical monopolist of a certain product or products and geographic candidate markets, such that the price increase would be unprofitable. The approach therefore takes account of possible barriers to entry (covered in paragraphs 7.141 to 7.166).

The product market

- 5.2 We start our analysis by focusing on the definition of the product market. As Marcroft's business was predominantly in the rail freight wagon maintenance sector, we begin by considering an appropriate definition of that sector

²²SI 1994 No 202 (C.6).

²³See *Merger References: Competition Commission Guidelines (CC2)*, paragraph 2.4 et seq. Paragraphs 2.7 and 2.8 explain that the CC will normally hypothesise an increase of around 5 per cent, whilst assuming all other prices remain unchanged.

Separate markets or a single market?

- 5.3 The various types of wagon maintenance are set out in paragraphs 4.9 and 4.10. Freight wagon owners would be expected to choose the maintenance solution that best meets their commercial and operational objectives. We considered the extent to which the different types of maintenance constituted a single product market or a set of separate markets. We did this by analysing the substitutability between them, in line with the approach set out in paragraph 5.1. As our guidelines make clear, if either customers can switch to other products (demand-side substitution) or if other producers can readily switch their facilities to supply alternative products (supply-side substitution) those products and producers form part of the relevant product market.²⁴ The possibility of either demand-side or supply-side substitution is sufficient. It is not necessary for both to be present.

CBM and SDG maintenance as substitutes for each other

- 5.4 These two types of maintenance are very similar. The significant difference is that under CBM, components are replaced in accordance with a predetermined schedule, whereas under SDG, components are replaced if tests on a sample of wagons in the fleet show that wear exceeds specified limits. We concluded that an attempt to increase the price of CBM above the competitive level could be expected to lead customers to switch to SDG instead (and vice versa), so that such a price increase would be unprofitable. The timescales over which such a switch could take place would generally be expected to be short and switching would not be likely to be expensive for customers. As a result of this demand-side substitutability, we concluded that CBM and SDG are in the same product market.

CBM and SDG maintenance as substitutes for GR maintenance

- 5.5 We were presented with convincing evidence both that wagon maintenance customers have the choice over which of these maintenance regimes they wish to adopt and that some of them have switched between GR wagon maintenance on the one hand and CBM or SDG maintenance on the other hand. We were also told that the time and costs necessary for a customer to switch between GR and CBM were not significant.²⁵ EWS told us, for instance, that it had moved from a GR- to a CBM-based regime over a period of approximately two years,²⁶ while VTG confirmed that it had switched from an SDG to a GR regime for some of its wagon fleet²⁷ (due to concerns about controlling quality under an SDG maintenance regime).
- 5.6 The clear potential for substitution between GR, CBM and SDG suggests that any attempt to increase the price of GR above the competitive level would be expected to lead customers to switch to CBM or SDG instead (and vice versa), so that such a price increase would not be profitable. As a result of this demand-side substitutability, we concluded that GR is in the same product market as CBM and SDG.

Light in-field maintenance as part of the same product market

- 5.7 Having concluded that the other three types of maintenance—GR, SDG and CBM—formed part of a single product market, we considered whether light in-field maintenance could be regarded as part of the same market.

²⁴*Merger References: Competition Commission Guidelines, (CC2), paragraph 2.1.*

²⁵EWS main submission to the CC, paragraph 4.40.

²⁶EWS main submission to the CC, paragraph 4.42.

²⁷*Summary of a hearing with VTG, paragraph 5.*

- 5.8 We were presented with evidence that it would be possible for a supplier of CBM or SDG to start a light in-field maintenance service, or for a light in-field maintenance provider to start a CBM or SDG based service, as all of these services could be provided in the field and do not require ownership of a workshop.²⁸ We would expect that such changes could be made relatively quickly and with little need for significant additional investment. We were also told that engineers who carry out light in-field maintenance can, and do, carry out CBM and SDG maintenance and that no significant additional training or equipment is required. We would thus expect that any attempt to increase the price of light in-field maintenance above the competitive level would be expected to lead suppliers of CBM or SDG to begin to offer light in-field maintenance (and vice versa), so that such a price increase was unprofitable. In the light of this supply-side substitutability, we concluded that light in-field maintenance is in the same market as CBM and SDG.
- 5.9 We similarly found that GR maintenance is substitutable on the supply side for light in-field maintenance. Any attempt by a hypothetical monopolist of light in-field maintenance services to raise prices 5 per cent above the competitive level would be expected to result in GR maintainers diversifying into the provision of light in-field maintenance services. Such firms would already possess the relevant tools, labour and experience to conduct such work, and would be expected to be able to diversify quickly and without the need for substantial additional investment. Such competition would be expected to make the price increase unprofitable, and so light in-field maintenance and GR maintenance would fall within the same relevant product market.
- 5.10 Even in the absence of the potential for direct supply-side substitution between GR maintenance and light in-field maintenance discussed above, there is also an argument that GR and light in-field maintenance fall within the same relevant product market on the basis of a chain of substitution. Following the discussion in the preceding paragraphs, we have concluded that (a) CBM and SDG are in the same market as light in-field maintenance on the basis of supply-side substitution, and (b) CBM and SDG are in the same market as GR on the basis of demand-side substitution. Therefore, a chain of substitution exists that would result in light in-field maintenance and GR maintenance being in the same relevant product market.

Conclusion: separate markets or single market?

- 5.11 Our analysis led us to the conclusion that light in-field maintenance, GR maintenance, CBM and SDG maintenance are all part of one single market for wagon maintenance services. EWS indicated that it concurred with this conclusion.²⁹ In reaching this conclusion, we recognized that the capabilities of maintenance service providers to offer particular types of maintenance could differ—though we were not offered any evidence of capacity constraints—and that entry barriers could vary for each type of maintenance; also that both factors could be relevant to our assessment of the competitive effects of the merger.

²⁸EWS main submission to the CC, paragraph 4.22(e).

²⁹EWS initially argued that there were three separate product markets (EWS main submission to the CC, paragraph 1.6). However, in response to our analysis of market definition, EWS agreed that the one-market definition was 'largely credible', though it did argue that we needed to evaluate the comparative strengths of supply- and demand-side substitution in relation to each type of market.

The position of in-house maintenance in the product market

- 5.12 A significant amount of wagon maintenance is undertaken on an in-house basis. EWS, which owns more than half of all wagons operating in Great Britain, carries out all of its own wagon maintenance. Of the other freight operating companies, Freightliner and DRS undertake some maintenance on at least some of their own wagon fleet (see paragraphs 4.26 and 4.27). GB Railfreight does no in-house maintenance. Equally, some private wagon owners, such as Plasmor³⁰ and STVA UK Ltd (STVA)³¹ undertake some maintenance on their own vehicles. Maintenance work undertaken on an in-house basis is, in practical terms, indistinguishable from that provided on a third-party basis. We therefore needed to consider whether the in-house provision of maintenance services forms part of the relevant economic market—and thus whether in-house provision exercises a competitive constraint on the market, including third-party maintainers—or whether the relevant economic market is confined to the provision of maintenance services to third parties.
- 5.13 Again, we used the approach set out in paragraph 5.1. We considered evidence that might suggest in-house maintenance providers would have the ability and the incentive to diversify and begin to supply maintenance services to third parties in the event of a 5 per cent price rise (ie the potential for supply-side substitution to occur), and evidence as to whether customers for maintenance services would be likely to switch to in-house provision, again given a 5 per cent price rise (ie the potential for demand-side substitution).
- 5.14 First of all, we applied this approach in relation to EWS's own in-house maintenance operations. EWS told us that it had been invited to bid for third-party maintenance contracts on only a few occasions in the past three years (see paragraph 7.10). EWS told us that its cost structure made it uncompetitive in bidding for such work, that it had not won any of the third-party maintenance contracts for which it had bid, and in the two instances where it undertook third-party maintenance it did so only either as part of a legacy contract dating from pre-privatization or as part of a very small third-party contract involving only five wagons.³² EWS also argued that its high cost base would make any attempt to sell wagon maintenance services to third parties irrational and pointed to evidence provided to us by third parties to the effect that its inability to compete in the market was widely recognized, submitting that therefore the bids it had entered did not thus act as a constraint on competition. Further information on EWS's cost structure is in paragraph 7.7. Comments on EWS's website about the scope of Axiom Rail's activities (see paragraph 2.3) were brought to our attention, as evidence that EWS was actively seeking to win third-party wagon maintenance contracts. However, we did not think that much could be inferred from these comments on EWS's intentions to provide maintenance services to third parties.
- 5.15 The evidence relating to contract negotiations over the past three years does not suggest that the option of switching to EWS has constrained the prices that Marcroft has charged its customers for third-party maintenance services. Therefore, despite the fact that EWS has bid for some third-party maintenance contracts, it does not appear to us that EWS has historically acted as a material supply-side constraint on Marcroft. Because this lack of effective competition arises partly from EWS's operating costs profile, it seems unlikely to change in the event of a small (but significant) price increase for third-party maintenance.

³⁰Plasmor carries out its own routine maintenance, and uses a third party maintainer for any substantial work, including annual inspections.

³¹EWS also told us that British Gypsum carries out its own maintenance (see *EWS main submission to the CC*, paragraph 5.5). However, British Gypsum told us that it does not do its own wagon maintenance, but uses a small third party maintenance provider.

³²EWS main submission to the CC, paragraph 6.4.

5.16 We also analysed the potential for other in-house maintainers to commence supplying third-party maintenance services in response to a 5 per cent rise in prices. Few wagon maintenance customers that gave evidence to us saw in-house maintainers as potential suppliers. In fact, when questioned directly, no customers named either Freightliner or DRS as potential suppliers of maintenance services. Similarly, (with the exception of the material on the EWS website about Axiom Rail, see paragraph 5.14) none of the in-house maintainers suggested that they were actively looking to use their in-house capability to maintain wagons for third parties. Despite this, EWS told us that it thought diversification into the supply of third-party maintenance was a likely scenario for all in-house maintenance providers other than EWS itself (because of its high cost base), particularly in the case of DRS and Freightliner.³³ It told us that an in-house provider could expand using the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE regulations),³⁴ to transfer staff across into its workforce as it won third party contracts, or that labour could be found on the open market to take on new contracts within three months.

5.17 We do not consider that either DRS or Freightliner could easily enter the third party maintenance market because:

- DRS has maintenance facilities at Sellafeld that allow it to perform minor repairs on its wagons transporting spent nuclear fuel. It has recently acquired an additional site in Scotland which is currently used for vehicle storage and which does not contain any facilities for wagon maintenance. DRS told us it had no current plans to undertake on an in-house basis the wagon maintenance undertaken by Marcroft, and that considerable investment would be needed in order for CBM and SDG maintenance to be carried out there. We do not consider that this constitutes a sufficient base from which to launch a third party maintenance service.
- Freightliner has a single maintenance location in Southampton, which is used to maintain its intermodal fleet, including some wagons leased from a range of companies. It also has access to sites at which Marcroft maintains Freightliner's Heavy Haul fleet. As discussed in paragraphs 7.56 and 7.169, Freightliner has recently acquired an additional facility in Leeds, which is to be used for locomotive maintenance. Again, we do not consider that this constitutes a sufficient base from which to launch a third party wagon maintenance service, particularly in view of Freightliner's statement that expanding its maintenance operation to include its own Heavy Haul fleet would be more expensive than the maintenance service currently provided by Marcroft, that it had failed to find a suitable workshop location, and that it had no current intention of taking on third party wagon maintenance.

5.18 We also consider it unlikely that wagon owners maintaining their own wagons in-house would have the incentive to enter the third party maintenance market, since running a third party maintenance business is neither the focus of their business, nor a market of which they have experience, nor a business that could easily, quickly and profitably be built up. We saw no evidence to suggest that a 5 per cent rise in the price of third party maintenance would be sufficient to induce in-house maintenance companies to attempt to diversify into the provision of third party maintenance.

³³EWS main submission to the CC, paragraph 8.14.

³⁴The TUPE Regulations apply to, among other things, 'service provision changes' where a contract is outsourced, assigned to a new contractor or bought in-house. In these situations, employees whose principal purpose is the carrying out of the activities concerned on behalf of the client automatically become employees of the new contract holder and it is as if (with very limited exceptions) their contract had originally been made with the new employer.

- 5.19 We also considered the ability and incentives for customers of wagon maintenance services to switch to providing services on an in-house basis, following a 5 per cent rise in the price of maintenance (ie the potential for demand-side substitution). All those firms responsible for wagon maintenance have made a decision either to set up an in-house maintenance service, outsource the work to third-party maintainers, or have opted for a combination of the two. EWS told us that it thought the ‘in-house provision of light in-field wagon maintenance services is a realistic alternative to third party provision’ and that switching would be simple and relatively quick, with little risk for all except the leasing companies which had no current in-house capability. EWS thought this extended to relatively small-scale private wagon owners; some, such as Plasmor, already have a degree of in-house maintenance capability. EWS also argued that in-house provision of GR maintenance was ‘a realistic alternative to third party provision, with the exception of very small companies or companies that have no access to workshop facilities’.
- 5.20 The evidence we received from third party maintenance customers indicated that they had little commercial incentive or wish to create or extend their in-house maintenance capability at present. This evidence is considered in more detail in paragraph 7.56. Equally, third-party maintainers did not see competition from in-house maintainers as a likely development (although one party told us that EWS had been actively competing for some wagon maintenance work, something EWS denied). We noted that most firms which maintained part of their fleet in-house quoted specific operational reasons for doing so, related generally to the fact that the part of the fleet that was maintained in-house was based at, or regularly flowed through, a single location where there was access to workshop facilities (EWS was the only in-house wagon maintenance provider we found which had a substantial range of locations for its maintenance operations). These firms saw substantial cost and operational obstacles to switching to in-house maintenance for the remainder of their fleets. In no case did wagon maintenance represent a core part of their business. Those that did say they might consider taking work in-house indicated that they would do so only in extreme circumstances, ie if no acceptable third-party supply was available; one noted that such a move would require a ‘major management change and would need careful consideration’.³⁵ Against the background of the barriers to market entry and expansion considered in paragraphs 7.141 to 7.166, we concluded that, given a 5 per cent increase in prices for wagon maintenance, customers would not seek to take significant amounts of further work in-house.
- 5.21 EWS told us that it believed that the relevant wagon maintenance market included both self-supply and third party provision but that an analysis of the competitive effects of the merger had to address whether EWS was able to act as an effective competitor in the third party market due to its high cost base. This seemed unconvincing to us. The evidence we found strongly suggested that in-house maintenance providers generally, and EWS in particular, do not act as a competitive constraint on third party maintenance providers (and vice versa). If EWS and Marcroft’s services do not compete—ie are not substitutes in the event of small but significant price increases—then they are not in the same economic product market.
- 5.22 We therefore concluded that in-house maintenance is not in the same relevant economic product market as third party maintenance. This conclusion means that EWS’s in-house maintenance provision is not in the same market as Marcroft’s maintenance activities.

³⁵Summary of a hearing with VTG, paragraph 11.

- 5.23 We therefore conducted our competitive analysis on the basis of a third party maintenance market, excluding in-house maintenance. We have also considered the sensitivity of our conclusions to a wider definition that included both third party maintenance and in-house maintenance as part of a single relevant product market.

Product definition: other considerations

- 5.24 We also considered whether a number of other activities that form part of the maintenance of wagons, or are in related areas, formed part of the relevant product market or constituted relevant product markets themselves.

Passenger carriage maintenance

- 5.25 There are a number of basic similarities between passenger carriages and wagons. For example, both share a set of similar components, such as bogies, wheelsets and drawgear. It was suggested to us that some passenger carriage maintainers were either active in the wagon maintenance market or could readily enter it. We thus considered whether the passenger carriage maintenance sector should form part of our product definition.
- 5.26 The evidence we found led us to conclude that passenger carriage maintenance forms part of a separate product market. Although some tasks are common—or at least very similar—across passenger carriage and wagon maintenance, the former requires a much greater skill set, eg to deal with air conditioning systems, electrical systems and other equipment found on passenger carriages but not on wagons. Staff involved in passenger carriage maintenance work are charged out at significantly higher rates (roughly double) than wagon maintenance staff and we were presented with evidence that suggested that margins were much greater for passenger carriage than for wagon maintenance, although Bombardier suggested that pricing and costs were higher in the passenger carriage maintenance market than for wagon maintenance. Additional equipment to that normally found in a wagon workshop is also required.
- 5.27 This evidence suggested that it was unlikely that a passenger carriage maintenance service provider would diversify into wagon maintenance given a 5 per cent increase in prices. While Bombardier has a rail freight maintenance contract,³⁶ this is a one-off and long-standing arrangement and most passenger carriage maintenance providers that gave evidence to us indicated that they did not wish to move into the wagon market, with any interest expressed restricted to workshop activities. We thus concluded that passenger carriage maintenance did not form part of the same product market as wagon maintenance. EWS has stated it believes that maintenance of passenger carriage vehicles falls within a product market distinct from wagon maintenance, though it has argued that the providers of carriage maintenance services are potential entrants into the wagon maintenance market.³⁷ However, EWS also argued that we should consider Bombardier, as a passenger carriage maintainer with a similar cost base to EWS and a small presence in wagon maintenance, to be as much of a competitive constraint as EWS (an argument Bombardier disagreed with; it told us that, because its primary business was new vehicle build, its business had significantly higher overheads than a conventional operator or maintainer would have). As noted in paragraph 5.22, we concluded that EWS was not a competitive constraint on third party wagon maintainers.

³⁶Summary of a hearing with Bombardier Transportation, paragraph 2.

³⁷EWS main submission to the CC, paragraph 5.6.

Specialist maintenance services

- 5.28 There are a wide range of different types of wagon, from standard box-type wagons to hoppers and specialist wagons designed to carry a large range of materials (from coal, aggregates and steel to motor vehicles, containers and petrochemical products). All require similar basic maintenance, while some also need more specialist work, for example on valve gear (tanker wagons) or hydraulic or pneumatic systems (automatic hoppers and tippers). We found no evidence to suggest that any of these constituted a separate market in themselves. The wagon maintainers, in their evidence to us, indicated that they had the ability to work on all types of wagon.
- 5.29 It was, however, put to us that two types of wagon maintenance were so specialized as to constitute separate product markets:
- (a) It was suggested that the process of ‘gas-freeing’ petrochemical tankers prior to maintenance being undertaken on them puts them into a separate category and that the fact that Marcroft had specialist gas-freeing facilities at its Stoke plant gave it a competitive advantage. We found, in fact, that the gas-freeing process generally takes place at several refineries using facilities provided by the petrochemical companies themselves before a wagon is passed to the maintainer for work to be undertaken on it. There are also mobile gas-freeing units which can be used, and it is a relatively low-tech process (though there are health and safety considerations to take into account). We also found that the gas-freeing facility at Stoke was relatively little-used,³⁸ while none of the wagon maintainers that submitted evidence to us identified the lack of gas-freeing facilities as a competitive problem or thought that they would be unable to work on petrochemical tankers. One customer did consider lack of gas-freeing facilities to be a concern; however, it seems likely that maintainers could subcontract this service easily enough. EWS argued that there were other relevant processes as well as a range of light in-field sites where gas-freeing could take place, pointing out that Marcroft itself sometimes did this work in the field.³⁹ We thus concluded that ‘gas-freeing’ petrochemical tankers did not constitute a separate product market.
- (b) It was also suggested that the sole right conferred upon Marcroft to undertake maintenance on AAE Megafret wagons constituted a competitive advantage on it, and that maintenance of these wagons might constitute a separate product market. Megafret wagons are high-speed container wagons, able to carry a 45-foot container which makes them particularly suited to the domestic intermodal sector. AAE leases wagons in the UK to four companies, with most (101 Megafret wagons) currently leased to DRS. We were told that all the Megafret wagons are maintained by Marcroft.⁴⁰ AAE confirmed that this was the case, noting that the small size of the UK market for the Megafret wagons deterred it from authorizing alternative maintainers but explaining that there was no reason why alternative maintainers should not be authorized, if necessary. Wabtec had maintained these wagons in the past. AAE also told us that where it was not responsible for maintenance as part of the leasing package, it was open to its customers to choose any provider as long as it complied with general technical requirements and certifications. The wagon maintainers that gave evidence to us suggested that they would be able to undertake maintenance on these wagons. If Marcroft were to attempt to increase the price of AAE Megafret maintenance, we would expect the lessees of such wagons to request that alternative

³⁸EWS main submission to the CC, paragraph 8.32.

³⁹EWS main submission to the CC, paragraphs 8.29 to 8.33.

⁴⁰Summary of a hearing with Direct Rail Services, paragraph 5.

maintenance companies be authorized to maintain their wagons instead. AAE would have an incentive to grant such authorization, in order to prevent damage to its future sales of AAE Megafret wagons, which could arise if the cost of maintaining such wagons were to rise. We thus concluded that this type of wagon did not form a separate product market.

Additional related product markets

- 5.30 We also looked at two related product areas in order to determine whether they were separate product markets for the purposes of assessing the competitive effects of the merger: component overhaul facilities and wagon conversion. These are dealt with below.

Component overhaul facilities

- 5.31 We considered the removal and fitting of overhauled and new parts to form part of CBM or SDG (see Appendix C paragraphs 4 and 5). It is common during such maintenance carried out in the field for components removed from wagons to be returned to the workshop for repair or overhaul. This is normal practice for wheelsets, for example, which require routine reprofiling on specialist equipment. A range of companies (eg Marcroft, Wabtec, LNWR, Hunslet-Barclay Ltd) carry out such component overhauls, but any of the engineering companies carrying out work on passenger carriages could also do so⁴¹ as long as they had the necessary equipment. There was thus a possibility that there was an upstream market for this work that should be examined. EWS stated that it believed it to be possible and plausible that there was a separate economic market for the overhaul of components, noting also that it was not active in the component overhaul market and there was a wider range of players providing such services than in the freight wagon maintenance market. Thus there was likely to be no adverse competitive effects as a result of the merger.
- 5.32 It is not clear whether the overhaul of components is in the same market as the provision of new components, for which they are presumably a substitute. Generally, while the replacement of a component may form a part of the functions of a maintainer, maintenance functions are not comparable with supply of components (new or overhauled). We therefore concluded that the overhaul and supply of components (as opposed to their removal and replacement in the course of light in-field maintenance) does not form part of the relevant product market for the purposes of our inquiry.

Wagon conversion

- 5.33 Marcroft also performs wagon conversion work, for example at the end of a lease period to convert wagons for different uses. It therefore appears that there is a related market for wagon conversion. EWS stated that it considered it to be possible that there was a separate economic market for the fabrication or conversion of wagons. It added that we would need to take account of the range of competitors active in this market, which was wider than in the GR maintenance market, and that EWS does not provide either service. We were given no evidence to the effect that Marcroft was able to exercise market power in this sector (against the background of a number of competing firms with sufficient workshop capacity to undertake wagon conversions) and thus do not consider it further.

⁴¹EWS main submission to the CC, paragraph 4.13.

Conclusions on the product market

- 5.34 We therefore concluded that the relevant product market is the supply of wagon maintenance services, comprising the elements set out in paragraph 4.9. We also concluded that the provision of in-house services, passenger carriage maintenance, component supply and overhaul and wagon conversion did not form part of the relevant product market.

Geographic market definition

- 5.35 Historically, the British rail network has not been connected to overseas rail networks and transporting wagons overseas, or bringing them to Britain, for maintenance purposes would have been prohibitively expensive. Since the opening of the Channel Tunnel in 1994 there has been some scope for interoperability between the British and overseas rail networks, though differences in the British and European loading gauges (ie the permitted height, width, length and weight of trains) reflected in the technical specifications of rolling stock, have meant that actual movements have been limited.
- 5.36 During our inquiry, we were made aware of measures to improve interoperability between Great Britain and overseas, including compliance with European Conventional Rail Technical Specifications for Interoperability for freight wagons.⁴² While this may, in theory, make it easier for foreign-based maintainers to expand into Great Britain,⁴³ in practice there is no evidence that this will have a material impact within the period relevant to our inquiry. EWS has indicated that, in the absence of any significant price increase in the relevant British wagon maintenance markets, it would not expect overseas wagon maintenance providers to be likely actively to seek entry into the British market in the next five to seven years. We were given evidence of only one instance of wagons operating in Britain crossing to Europe for maintenance purposes. We formed the view that if a hypothetical monopolist were to attempt to implement a small but significant increase in the price of maintenance services in Great Britain, we would not expect customers to be able to switch to alternative suppliers from other geographic areas, and so such a price increase would be expected to be profitable. No-one presented evidence to us that suggested that the market was anything other than purely a Great Britain market.
- 5.37 Similarly, we found no evidence to suggest that there were regional markets within Great Britain. Nearly all of the wagon maintainers indicated to us that they offered—or were prepared to offer—maintenance services in the field at outstations throughout Britain (subject to gaining access to appropriate sites where these were not already available to them at no or insignificant cost) while wagons are regularly moved across the country for GR maintenance purposes.⁴⁴ Though not all customers accepted that all maintenance providers could provide national coverage for maintenance in the field (and neither did we—see paragraph 7.51), we consider that maintainers with less coverage still form a part of the overall market of Great Britain. EWS stated that there were no regional differences between services provided as part of light in-field, GR, CBM or SDG maintenance.

⁴²Published in the *Official Journal of the European Union*, pursuant to the Conventional Directive (2001/16/EC) adopted by the European Commission as part of the Second Railway Package in 2004, and implemented in the UK by the Railways (Interoperability) Regulations 2006. These specifications will apply only to new, renewed or upgraded rolling stock and only to rolling stock in use on the Trans-European Network (in effect, UK main lines). The UK policy is to apply the requirements to all rolling stock.

⁴³EWS main submission to the CC, paragraph 4.57.

⁴⁴EWS main submission to the CC, paragraphs 4.54 and 4.55.

Conclusions on the geographic market

- 5.38 We thus concluded that the relevant geographic market is Great Britain. This view is shared by EWS.⁴⁵

The haulage market

- 5.39 We also considered the downstream services provided by EWS, in the supply of which it competes with certain customers of wagon maintenance services. The two key activities that could be described in this way are (a) haulage services (in which EWS competes with companies such as Freightliner, DRS and GB Railfreight) and (b) wagon leasing (in which EWS competes with companies such as VTG, GE Rail and NACCO). When considering the competitive effects of the merger, we examined the impact that it may have on competition in the supply of these downstream services.
- 5.40 In relation to this analysis, we considered whether there was a single market for the supply of haulage services, or whether there were separate markets for different types of haulage (such as coal haulage, petrochemical haulage, intermodal haulage and so on).
- 5.41 We concluded that the relevant haulage market was no wider than freight haulage by rail. We do not consider that haulage by road is part of the same relevant product market, due to the fact that road haulage is not a sufficiently close substitute for rail haulage when transporting large volumes of bulky goods, and also due to differences in competitive conditions, infrastructure and regulatory regimes. The potential for separate submarkets for different types of haulage services, and wagon leasing, was also taken into account.
- 5.42 We also considered whether there was a discrete market for wagon leasing or whether, for the purposes of this inquiry, wagon leasing could be viewed as a part of the wider haulage market. The competitive conditions in the supply of different types of haulage services might vary between the various market segments. Further it would appear that leasing was ostensibly a complementary activity to haulage; in order to transport goods, it is necessary both to have access to a wagon (either through leasing, ownership or as part of a bundled haulage service) and also to have access to the means to haul that wagon. However, for customers of haulage services whether the wagons being hauled are leased or owned by the haulage provider is not necessarily important. We concluded therefore that haulage services involving wagons leased from leasing companies were part of the haulage market (or any separate haulage markets defined by end-use of the transported products).
- 5.43 When considering whether the merger would result in an SLC relating to haulage, therefore, we also considered whether our conclusions would be altered if haulage was made up of several distinct markets (for example, if coal haulage was a separate market from petrochemical haulage) (see paragraph 7.131).

Conclusions on the market definition

- 5.44 We conclude that the relevant market for this investigation is that of the supply of wagon maintenance services in Great Britain. This comprises light in-field maintenance, CBM, SDG and GR maintenance provided by third party maintenance

⁴⁵EWS main submission to the CC, paragraph 4.53.

providers. It excludes the provision of in-house services, passenger carriage maintenance, component overhaul and wagon conversion.

- 5.45 The merger was also assessed for its impact in the downstream markets for haulage services and wagon leasing.

6. Counterfactual

- 6.1 We turned next to consider what we expect would have happened had the merger not taken place (the counterfactual).⁴⁶ This is important because, in considering the competitive effects of this completed merger, we must compare the effects of the merger with what would have happened to Marcroft in the absence of the merger.
- 6.2 EWS told us that if the merger had not taken place when it did, it believed that Marcroft would inevitably have gone into administration. It told us that, based on the information it had seen on the bidding process in the summer of 2005, it thought only Wabtec would have been interested in acquiring the outstation business of Marcroft, and that there would have been no interest in acquiring the Stoke workshop for continued rail-related use.
- 6.3 We generally consider it appropriate to assume as the basis for the counterfactual that the acquiring company never took any steps to bring about the merger that the CC has to consider. This would appear to be particularly appropriate in this case as the competitive conditions changed after the agreement in principle to merge, and possibly as a result of that agreement (for example, after EWS and Marcroft agreed in principle on a merger, EWS tendered for two Network Rail contracts using Marcroft as a proposed subcontractor to carry out the maintenance elements of the contracts, see paragraph 6.32. EWS told us that its decision to subcontract with Marcroft was independent of its decision to acquire the business). Our starting point in deriving the counterfactual in this case, therefore, is that EWS, like the other recipients of the information memorandum, never bid for Marcroft. Without this bid (received in August 2005), Marcroft would have had to pursue other options. In developing our views we did bear in mind Marcroft's financial performance from August 2005 onwards (see Appendix E, paragraphs 1 to 3).

Marcroft's situation in August 2005

- 6.4 We first looked at Marcroft's position in August 2005. Its total business could be considered as consisting of two main parts and was indeed accounted for in this way (see Appendix B, Table 2). One was based on the outstations (the outstation business), which fulfilled contracts to provide maintenance services in the field to customers, and one was based on the Stoke depot (the workshop business), which specialized in carrying out GR maintenance, component overhaul and painting. In many cases both parts of the business contributed to the fulfilment of contracts. The Stoke depot was also the head office of Marcroft, and was the location of the administrative, engineering and other support functions for both businesses. The outstation business generally made a positive contribution to Marcroft's overheads; the workshop business did not (see Appendix B, Table 2).
- 6.5 Marcroft's most valuable fixed asset was the site in Stoke, comprising land and buildings (see Appendix E, paragraph 4). Its outstation business was also of value

⁴⁶*Merger References: Competition Commission Guidelines, (CC2), June 2003, paragraph 1.22.*

(see Appendix E, paragraph 5), and there were tax losses which may have been of value to a purchaser (see Appendix E, paragraph 6).

The alternatives to an acquisition by EWS

- 6.6 We looked at the alternatives to an EWS acquisition. Our starting point was that Marcroft had not received a positive response from any of the companies it approached in July 2005 about a sale of the business. In this situation, we considered that Marcroft's shareholders would have a very strong incentive to take action so as to avoid administration, including seeking alternative purchasers for all or some of the business (it had not previously sought or entertained offers for the outstation business alone).

Marcroft retaining both the outstation and workshop businesses

- 6.7 First, we considered whether Marcroft would have continued to run both the outstation and workshop businesses itself. Given Marcroft's declining financial position, we thought it was unlikely to survive on a stand-alone basis without obtaining additional finance, and that additional finance was unlikely to be forthcoming (for reasons set out in Appendix E, paragraph 8). In the absence of new finance, we considered administration to be a possible outcome (Appendix E, paragraph 9). We did not, however, think that Marcroft's shareholders were likely to have let the business reach such a position (see Appendix E, paragraphs 10 to 11), and did not consider it to be the most likely counterfactual.

Marcroft selling the whole business

- 6.8 Next we looked at whether Marcroft would have found an alternative buyer for the whole company. As noted in Appendix E, paragraphs 13 to 14, Marcroft would have needed to approach alternative potential acquirers. Evidence received from EWS suggested to us that, immediately prior to completion of the acquisition, it thought that there were alternative purchasers for the whole business, albeit in a strengthened form, and that any sale would have involved ensuring Marcroft's customer base would not object and move to other maintenance providers.
- 6.9 We noted that any possible sale of the business (or part of it) would require Marcroft to ensure that its customers were satisfied with the proposed sale, and would not move their maintenance requirements elsewhere (given the lack of formal contracts, as noted in paragraph 7.9) because of the identity of the purchaser, or if, following the sale, Marcroft no longer had a workshop and had to subcontract all its GR maintenance work. We were told that when EWS agreed to purchase Marcroft, representatives of the companies visited all their major customers to reassure them that the merged entity had no intention of raising prices. This approach seems to have been successful as we are not aware of Marcroft having lost significant customers since the acquisition was announced.
- 6.10 Whilst a sale of the whole business therefore seemed to us to be possible, only one party that gave us evidence indicated to us that it might have considered bidding for the entire company if it had been aware of the sale process. While we have not approached every possible acquirer, the most credible potential purchasers did not express an interest in the company as a whole.
- 6.11 On balance, while the sale of the whole of Marcroft is possible, we concluded that it was not a likely scenario.

The Stoke workshop

- 6.12 We then considered what would have happened to the two separate parts of the business: that based on the Stoke workshop, and the outstation business.
- 6.13 The Stoke workshop was seriously underutilized, and costly to operate. VTG told us that there had been a significant investment in the Stoke site in the mid-1990s, so that it could be used for the manufacture of new wagons. EWS told us that there had been little investment since that date and consequently the workshop was now in urgent need of attention.
- 6.14 Management accounts show that the Stoke workshop business had been making losses prior to 2005 (£[redacted] in 2003 and more than £[redacted] in 2004). In 2005, the Stoke workshop did generate a contribution of almost £[redacted] towards the central overheads of £[redacted] (see Appendix B, Table 2). However, in the first two months of 2006, Stoke made a negative contribution (loss before overheads) of almost £[redacted].
- 6.15 EWS stated in its submission that there was excess capacity in workshops in Great Britain; we saw no evidence that the closure of the Stoke workshop would lead to a shortage of workshop capacity. Some customers suggested that they would prefer their maintenance provider to offer the full range of services, rather than have to subcontract workshop services, unless the customer could be satisfied about quality and guaranteed access, but it appeared to us that this was a customer preference rather than a requirement (EWS itself has no workshop for its 12,000 wagons, subcontracting the refurbishment of spare parts, the reprofiling of wheels and any other workshop-related activity, much of it to Wabtec).
- 6.16 If Marcroft had decided to sell the Stoke workshop separately from the outstation business, it is likely that a different use would have been made of the Stoke property by a purchaser, and it would have ceased to be available for participants in the wagon maintenance market, particularly for those customers seeking GR maintenance. It would represent a large overhead for any potential purchaser who kept it in its present use. Only two parties we spoke to expressed an interest in acquiring the Stoke site for rail-related purposes, and it is far from clear that this would have been a priority for one of the parties (it may have been interested, but only if it had seen the sale as a significant threat to its core business), or that the other would have been able to acquire it. We were also told that a further third party had verbally suggested that it might be interested in acquiring the Stoke site for rail-related purposes but there was no indication that this was ever followed up by that third party. Marcroft told us it had received several expressions of interest in the Stoke site from property and development companies.
- 6.17 We concluded, therefore, that in the absence of the merger the Stoke workshop and site would have been sold to someone who would have used them for purposes not related to wagon maintenance. EWS agreed with this conclusion.

The outstation business

- 6.18 We then looked at what would have happened to the outstation business if the Stoke property were put up for sale. We considered whether the existing owners of Marcroft would have been able to continue to operate the outstations as a stand-alone business, or whether it would have been sold.
- 6.19 We looked first at whether Marcroft would have retained the outstation business. As noted in paragraph 6.4, it generally made a positive contribution to Marcroft's overheads. Whilst the outstation business relied on the workshop business for such

things as overhauling for some types of components and fulfilling GR elements of maintenance contracts, had Marcroft not possessed a workshop it could have obtained these services for its outstation business from other workshops. [REDACTED] The lack of a workshop in Stoke would not, therefore, have prevented it from being able to offer maintenance in the field, or to offer to arrange GR work. EWS, however, argued that it was implausible that Marcroft could or would have continued to operate the outstation business.⁴⁷

- 6.20 If the directors of Marcroft had wanted to continue to run the outstation business, they would have had to ensure continuity of financing, while the Stoke property was sold and the secured loans repaid. There would have been a delay, possibly as long as two to three years, before the site sale was completed and any surplus after loan repayments was received (EWS told us that it had taken it over two years to complete the sale of a similar site elsewhere). The invoice financing facility could in principle have been continued with the existing lender or another one; Marcroft told us that any such change to the business would have led to its existing lender renegotiating the terms of the loan. In any event, there would have been a requirement for some new finance for working capital (principally stocks of spare parts and operating equipment), fitting out a new head office (probably rented), and some fixed assets.
- 6.21 This might have been possible, particularly if bank finance were available, but we noted the unsuccessful efforts of the same management to raise bank finance for Marcroft during 2005 when it owned a property with a value well in excess of the amounts of the loans secured on it. If the principal shareholder, whose loan notes were secured by a third charge on the Stoke property, had been content to continue on a long-term basis with only a floating charge, the financing needs would have been reduced. He told us that he would have required repayment of the loan notes in such circumstances; however, we found it difficult to see that a bank would have provided finance to repay loan notes when there were more urgent calls within the business for finance. But we believe that a successful continuation of the outstation business in existing ownership would have depended in the end on a quick sale of the Stoke property, which we considered to be unlikely, for an amount close to its valuation of £[REDACTED]. However, if an early sale were nevertheless achieved, we considered that Marcroft retaining the outstation business would be a realistic scenario.
- 6.22 We then considered the possibility of Marcroft selling the outstation business. Before the MBO in February 2004, VTG had received expressions of interest from one company that later abandoned its bid, and from two others, Davis and Wabtec, that only wanted to acquire the outstation business. Freightliner told us that it too had expressed an interest in acquiring Marcroft. [REDACTED]
- 6.23 Marcroft told us that, in the absence of a bid from EWS in August 2005, it would have approached customers such as Freightliner and GB Railfreight. [REDACTED], Wabtec told us that it expressed an interest, and Davis told us that it would have been interested in bidding for the outstation business (without the Stoke workshop) in the summer of 2005.
- 6.24 Marcroft's former main shareholder told us that he thought that Marcroft's bankers would have been reluctant to let the directors undertake a break-up of Marcroft, and would have wanted the process supervised by an administrative receiver. [REDACTED] As

⁴⁷Though EWS did make clear to us that it believes that it is not necessary to own a workshop to run an outstation business.

already pointed out, EWS told us that it thought that administration was an unavoidable outcome in the absence of its bid.

- 6.25 We think that it would have made little difference to our competitive analysis (in the context of assessing the most likely counterfactual) whether the break-up was carried out by an administrative receiver, an administrator or by the directors. On balance we believe it is most likely that the Stoke property would have been sold to meet the claims of the senior creditors whose loans were secured on it, and the outstation business too would have been sold. It is possible that the outstation business would have been split up and sold to more than one buyer if Marcroft had been put into administration or administrative receivership.
- 6.26 EWS told us that, in its view, Wabtec was the only likely alternative purchaser for the whole outstation business, and said that a sale to Wabtec would have resulted in a worse competitive outcome. It told us that Davis's past interest had come to nothing [X]. On Freightliner it told us that it thought Freightliner's purported interest was overstated. On VTG, EWS told us that VTG was very unlikely to want to buy all the outstation business, just that which was needed to maintain its own wagons.
- 6.27 However, the evidence we received from third parties indicated to us that there was a greater level of interest. We noted [X] had been unhappy not to have been included in the Marcroft sale process in the first place. We thought it would be a credible alternative potential purchaser of the Marcroft outstation business. We also considered that Freightliner was a credible alternative purchaser, though we did bear in mind that, during our investigation, Freightliner did have an incentive to play up the interest it had in acquiring the business in 2005, and we noted that it had previously told the Managing Director of Marcroft that Freightliner had not been interested in acquiring Marcroft (see paragraph 6.22). As for VTG, it had previously owned a third-party wagon maintenance business and could own one again, especially if it thought that such a business would be more viable (for example, if the business was not encumbered with the loss-making Stoke workshop) or would be an economically more advantageous proposition than just servicing its own wagons, because of economies of scale. It told us that it was unlikely to buy the whole business, but later said that it might be a potential buyer for the outstation business without the Stoke workshop (though VTG did consider a purchase of Marcroft would be a last resort for it).
- 6.28 We concluded that, with its strong market position and its importance as a provider of an essential service to a range of customers, the outstation business would have attracted the attention of several potential buyers, both competitors and customers. In our view, likely purchasers would have included Davis, Freightliner, Wabtec and possibly VTG.

Conclusion on the counterfactual

- 6.29 We conclude that, in the absence of the merger, the Stoke site would have been sold, and it would probably have been given over to a different use given the lack of likely trade buyers for it. We further conclude that the outstation business would have remained active, probably in new ownership.

What EWS would have done if it had not acquired Marcroft

- 6.30 Having concluded on what we expected would have happened to Marcroft in the absence of the merger, we looked at what EWS may have been expected to do had it not acquired Marcroft.

- 6.31 In September 2005, EWS launched a new brand, Axiom Rail, aimed at providing engineering services for third parties. In its launch press release, it said that Axiom Rail offered maintenance and service support to customers who operate, among other things, freight operations. The creation of the brand was part of a strategy involving increasing its portfolio of customized maintenance activity.⁴⁸ It was put to us by a third party that this indicated EWS's intention to start offering third-party wagon maintenance services.
- 6.32 EWS told us that, by late 2005,⁴⁹ it had come to the realization [⌘]. It had submitted quotes for two Network Rail tenders in late 2005 and early 2006, in which it had proposed subcontracting to Marcroft the wagon maintenance elements of the contract. In the event, it was not successful in either tender.
- 6.33 We noted that its quotes for these Network Rail tenders were both made after the formal agreement to acquire Marcroft had been made, and may have been an effect of the (then agreed but not completed) merger. However, we saw no reason to expect that EWS's in-house wagon maintenance capability would have been an integral part of the Axiom Rail brand had the merger not taken place, as it only provided third party maintenance services to two customers, and EWS had only been invited to tender for contracts on seven occasions in the past three years (see paragraph 7.10).
- 6.34 We concluded, therefore, that if EWS had not acquired Marcroft, EWS would either have continued as it had prior to the merger, or sought to quote for tenders, subcontracting the wagon maintenance elements of the contracts to a third party provider (be it Marcroft or another provider). In both scenarios there would have been the same number of suppliers of third party maintenance services as before the merger. Hence, in our counterfactual, EWS would have placed no greater competitive constraint on third party maintenance providers than it had done prior to the merger.

7. Assessment of the competitive effects of the merger

- 7.1 In this chapter we set out our assessment of the competitive effects of the merger. First we looked at how competition works in the market and some trends of relevance to our analysis (see paragraphs 7.2 to 7.15). We then turned to look at the expected effects of the merger compared with what would have happened in the counterfactual, to see if we expected there to be any SLC as a result of the merger. We did this by first considering whether Marcroft had a degree of market power (see paragraphs 7.22 to 7.59), then by considering the effects of the merger in the wagon maintenance market and the haulage market. Finally, we looked at whether any SLC would have been prevented by market entry (or the threat of it) (see paragraphs 7.134 to 7.172) or customers being able to exert countervailing buyer power (see paragraphs 7.173 to 7.179).

Market concentration and entry/exit

- 7.2 We started by looking at market concentration in the wagon maintenance market. With the reduction in the number of wagons needing maintenance over the past 40 years (see paragraph 4.3) there has been gradual consolidation and exit from the wagon maintenance market over the same period, to the point where there are two

⁴⁸EWS press notice 30 September 2005.

⁴⁹Marcroft told us that discussions on EWS bidding using Marcroft as a subcontractor started in early September 2005, well before the merger was agreed (though after EWS had been granted exclusivity in negotiations to acquire Marcroft).

providers of third party maintenance with significant market shares (Marcroft and Wabtec), and a few maintenance providers with small (less than 5 per cent) shares of the market.

- 7.3 There has been some small-scale new entry into this market (see paragraph 4.19), but there has been no large-scale new entry in recent times. The extent to which this may have been caused by the wagon maintenance market being unattractive to enter or there being barriers to entry into the market is discussed in paragraphs 7.134 to 7.172.
- 7.4 There has been some recent entry into, and expansion within, the haulage market. EWS and Freightliner were formed from the haulage businesses of British Rail. Since then there has been some expansion within the market, notably the move of Freightliner into the bulk freight market (see paragraph 4.25), the expansion of DRS from its original business transporting spent nuclear fuel into other high-value haulage (see paragraph 4.27) and the formation of GB Railfreight (see paragraph 4.28). Whilst there has been some growth in the size of the haulage market, [REDACTED].

Pricing, profitability and other conduct issues

- 7.5 In this section we consider how competition works in the market. This includes the pricing of wagon maintenance services, the profitability of these services, the extent to which tendering for work takes place, how maintenance providers are chosen, and the extent to which customers switch between maintenance providers.

Pricing

- 7.6 The information we received on prices charged by maintenance providers, hourly charge-out rates and hourly wage rates for their staff, did not lend itself to easy comparison. Some contracts are charged based on an hourly call-out rate per employee, others based on a monthly charge for maintenance of a fleet of wagons, others by charge per GR event. It was clear, from evidence we received on [REDACTED] call-out rates for different contracts, that different customers are charged different rates, though [REDACTED] argued that the different rates reflected different services provided. On the whole it appeared to us that third party wagon maintenance providers charged labour at broadly similar rates, though we noted a representation that there had been significant variation in total cost quoted for some wagon maintenance work (see paragraph 7.52).
- 7.7 In-house maintenance providers were unable to provide us with data on internal transfer pricing for their services. EWS provided us with details of the rate it charged the two organizations for which it did supply third party wagon maintenance services, as part of a package of freight services provided by it. [REDACTED]⁵⁰ We then conducted our own analysis of labour costs, comparing EWS with Marcroft and Wabtec. We included all employee-related benefits and costs in addition to basic pay, to take account of differences in benefit packages. We included all maintenance staff (rather than looking at the cost of individual employees) to eliminate differences in the composition of maintenance teams between the companies. We then derived an hourly rate based on standardized working hours. [REDACTED] Our analysis therefore suggested that [REDACTED] would not be sufficient to prevent EWS from competing for third party maintenance contracts. [REDACTED] This, in turn, suggested that its [REDACTED] would not be sufficient to prevent EWS from competing for third party maintenance contracts.

⁵⁰This comparison was between an EWS Team Member grade 1 and a Marcroft Skilled Fitter grade 1.

EWS, however, disagreed with this analysis. We do not rely on this assessment of EWS's costs in reaching our views on the competitive effects of the merger.

Profitability

- 7.8 We noted that wagon maintenance was not regarded as a high-margin operation. Overall Marcroft was loss-making, largely due to the high overheads associated with its Stoke workshop. Wabtec told us that its wagon maintenance business was profitable, but that it was a low-margin business, whereas its passenger carriage maintenance work offered higher margins. Both Davis and Steele also told us that they were profitable.

Customer relationships

- 7.9 While there are some exceptions, maintenance contracts are usually of a rather informal nature. Many contracts appear to be unsigned or unwritten but are nevertheless honoured by the parties (for example, EWS told us that Marcroft [✂]). Marcroft told us that the lack of formal contracts is the customer's choice. The relationships between maintenance providers and customers are usually long-standing: for example, data submitted by Marcroft shows an average length of customer relationship of nine years, Davis stated that its average length of customer relationship was ten years, and Wabtec stated that its average length of customer relationship was five years.

Tendering

- 7.10 The number of formal tenders in the sector is uncertain but we believe it is limited. EWS told us that it had been invited to bid in seven tenders over the last three years and had not won any. At an oral hearing, Marcroft estimated that there had been around 20 formal tenders over the last three years. We asked Marcroft to provide us with a list of formal tender processes⁵¹ in which it had been involved since the start of 2003. The list provided by Marcroft showed a large number (over 250) of 'business opportunities', of which, we were told, 165 were formal tenders issued by 44 customers. However, our analysis, including comparison with information provided by customers, led us to believe that many of these 'business opportunities' and invitations to quote could not accurately be described as formal tender processes for wagon maintenance. For example, over 40 business opportunities appeared to relate to activities which did not fall within our definition of wagon maintenance, 25 related to customers who told us that they do not use tenders or had not done so during the relevant period, 23 related to a customer who told us that Marcroft was their major supplier and they would only seek tenders from others if Marcroft was unable to do the work, and nine related to work tendered by EWS. For 30 of the 165 business opportunities, the customer decided not to proceed with the work in question. EWS and Marcroft disputed our analysis of this data.

Switching

- 7.11 We received some evidence seeking to show that customers frequently switched wagon maintenance provider. Marcroft suggested that more than one-third of the open market maintenance market had been tendered (and so the customer had at

⁵¹In this context, formal tenders are situations where a customer issues an invitation to tender and potential suppliers submit written bids in response to that invitation, and hence where the tender is subject to competition between suppliers. This does not include discussions between a customer and a supplier subject to a framework contract that was already in existence.

least considered switching supplier) one or more times since 2003. However, we thought this overstated the case. For example, three of the eight tenders cited by Marcroft were from Network Rail, and accounted in aggregate for 1,855 wagons, a number which is significantly more than the number of wagons that Network Rail told us that it possesses (see paragraph 4.31). Network Rail confirmed that 555 of its wagons had been included in two of the tenders. We also noted that even if Marcroft's calculation had been correct, it would mean that on average only just over 10 per cent of the market is tendered in any year (with the possibility, but not certainty, of switching).

- 7.12 In fact, as noted in paragraph 7.9, wagon maintainers tend to have long-established relationships with customers. The number of occasions that maintenance business has been switched to another party following retender or renewal is therefore limited. EWS identified only nine changes in maintenance provider over the last five years. These changes of maintenance provider affected 941⁵² wagons over the last five years, accounting for approximately 13 per cent of wagons currently maintained by third parties. This lack of switching may be symptomatic of a barrier to entry or expansion (see paragraphs 7.141 to 7.172).
- 7.13 On the basis of the available evidence, we found that the market is characterized by long customer-supplier relationships, with little switching between suppliers. Whilst small pieces of work on the fringes of the market appear to be subject to competition between maintenance providers, each customer's core maintenance requirements are typically met by a single company, with retendering of maintenance requirements only arising in cases where the quality of service provided by the incumbent maintenance company is unsatisfactory or, (as in the case of Network Rail) formal tendering is required because of EU procurement rules. In some cases, a customer will have wagons it owns and wagons it leases maintained by different companies, or a customer may have most of its work done by one maintainer but use a small company to maintain wagons in a particular area.
- 7.14 We did receive limited evidence that customers had changed maintenance provider due to a poor quality service from their previous provider. Three examples were cited, and a further customer of wagon maintainers told us that, based on past dealings, it was not convinced that the other two maintainers with which it had dealt would give its fleet the same level of service as it currently received. EWS provided us with data on customer switching of maintenance provider. It showed that in seven of the nine cases of switching identified in the past five years, the switch was the result of a competitive tender. We have heard a variety of views on the number of tenders taking place in the last few years, but believe that the number of formal tenders was significantly less than the number of business opportunities discussed in paragraph 7.10. The lack of switching and price variation (see paragraph 7.6) suggested to us that there may be some advantage for incumbents when maintenance contracts are renewed or retendered.

Criteria for contract awards

- 7.15 We asked customers what factors they took into account when deciding whether to award a maintenance contract to a maintenance provider. The main factors put to us were the financial stability of the company (whether the customer was confident that the company was likely to be able to fulfil the contract for its entire duration), the health and safety aspects of the potential provider, price and quality of service. In terms of financial stability, we did note that Marcroft had not been in a very strong

⁵²Source: EWS, Wabtec.

financial position recently but had not appeared to lose work because of this; it may be that a company's financial stability is considered when awarding a contract to a wagon maintainer for the first time but not subsequently.

Effects of the merger

7.16 Having looked at how competition takes place in the market, in this section we consider the effects of the merger. We do this by considering first Marcroft's pre-merger positioning in the wagon maintenance market, including whether it had a degree of market power prior to the merger. We then consider the effects of the merger in the wagon maintenance market, including the scope for non-coordinated effects and coordinated effects. We then consider the effects of the merger in the haulage market. In these sections we also consider whether the merger may be expected to give rise to any adverse effects. After this, we consider whether any adverse effects that the merger may be expected to have would be prevented, by competitors either entering the market or expanding within it, or by customers exerting countervailing buyer power.

Marcroft's pre-merger position in the wagon maintenance market

7.17 Table 6 presents data on market shares prior to the merger. The first column in Table 6 sets out the market shares for the supply of light in-field maintenance to third parties, by number of wagons maintained (on the basis of estimates provided by EWS). This represents the share of light in-field maintenance under the counterfactual, with EWS's market share of 3 per cent representing its third party maintenance for two customers. The right-hand column shows market shares for the supply of *all* maintenance to third parties (that is, light in-field, GR, CBM and SDG), by total revenue generated in 2005 (on the basis of data submitted by the various market players). We normally look at measures of the degree of concentration in the market,⁵³ using the Herfindahl-Hirschmann Index (HHI). The HHI for the supply of maintenance to third parties before the merger was 4,752 on the basis of the revenue data (or 4,260 on the basis of light in-field maintenance market shares). HHIs of this magnitude are indicative of a highly concentrated market.⁵⁴

7.18 Marcroft suggested that the market share analysis should reflect the proportion of wagons that were 'secured' to a maintainer through binding contracts, noting that whereas it had only one such contract (with VTG), it was likely that the majority of the wagons under Wabtec maintenance would be secured in this way. In view of the long-term relationships wagon owners have with their maintainers (see paragraph 7.9) and the low level of switching in the sector (see paragraphs 7.11 to 7.14), we were not persuaded that this approach would provide a more accurate picture of the market.

7.19 EWS said that it would be misleading to draw conclusions as to EWS's competitiveness in wagon maintenance (both third party wagon maintenance and all wagon maintenance) on the basis of market shares, as they did not reflect EWS's cost base, and that their third party maintenance work was small and an incidental part of freight haulage agreements.⁵⁵ EWS also suggested it was unsafe to rely on these data as indicative of market shares. It pointed out that the ages of the wagons in individual fleets (and thus the amount of maintenance they required) could produce

⁵³ *Merger References: Competition Commission Guidelines, (CC2), June 2003, paragraph 3.9.*

⁵⁴ *Merger References: Competition Commission Guidelines, (CC2), June 2003, paragraph 3.10.*

⁵⁵ EWS main submission to the CC, paragraphs 6.4 and 6.5.

distortions. However, EWS was unable to suggest an alternative way of deriving market shares.

7.20 EWS argued that our estimates of market share of all third party maintenance by revenue must be incorrect, [REDACTED].

7.21 We were content that our market share calculations were not erroneous. Our market share figures were calculated from actual revenue figures provided by the main and third parties. We noted that volume-based market shares for light in-field maintenance and GR maintenance provided by EWS were estimates (and that EWS had told us that there was no available industry data on numbers of GR maintenance so that the market shares provided for GR maintenance could therefore only be rough estimates⁵⁶). We considered that the revenue-based estimates based on actual revenue data were likely to be a more relevant way of calculating market share, and were more accurate.⁵⁷ [REDACTED]

TABLE 6 Shares of third party maintenance prior to the merger

Maintenance provider	Share of third party light in-field maintenance by number of wagons*	Share of all third party maintenance by revenue†
Marcroft	56	[REDACTED]
EWS	3	
Wabtec	34	
Bombardier	3	
Davis	3	
Steele	1	
Arlington	-	
Freightliner	1	
Channel Commercials	0	
Other	-	
Total	100	

Source: EWS main submission to the CC, Table D, maintenance company data and CC analysis.

*Total wagons 7,000. Shares calculated as at March 2006. EWS recalculated market shares for us in August 2006: the only changes were that Marcroft's market share reduced by 2 per cent (with Marcroft maintaining 164 fewer wagons than in March) and Freightliner's market share increased by 2 per cent (with Freightliner maintaining 151 more wagons for third parties than in March). The wagons maintained by Freightliner were leased by Freightliner from GE Rail Services.

†Total revenue £[REDACTED].

Notes:

- Share of all third party maintenance by revenue assumes that Alstom conducted no GR maintenance in 2005. This is consistent with EWS's assessment, as shown in Table E of EWS's main submission to the CC.
- Columns may not sum due to rounding.

Market power

7.22 In assessing whether Marcroft already had a degree of market power prior to the merger, we first considered Marcroft's position in light of our guidelines. We then considered the extent to which Marcroft's competitors could offer an alternative to customers of haulage services.

Market shares as an indication of market power

7.23 Our guidelines set out how market shares of firms can indicate the potential extent of a firm's market power.⁵⁸ They note, for example, that 'a firm with a large market

⁵⁶EWS main submission to the CC, paragraphs 6.10 and 6.11.

⁵⁷The only company for whom we were unable to obtain revenue data was Alstom, which EWS told us was active in GR maintenance.

⁵⁸See *Merger References: Competition Commission Guidelines, (CC2)*, paragraph 3.3.

share relative to other firms in the same market may have the ability to raise its prices independently of other firms, at least to some extent'. A large market share relative to other firms may similarly give a firm the ability to lower service quality independently of other firms.⁵⁹ However, the guidelines also note that a firm with a large market share will not always be able to exert market power. Hence features such as the extent of switching costs, threat of entry and countervailing buyer power will affect a firm's ability to exercise market power. We consider each of these elements in turn below.

- 7.24 As shown in Table 6, Marcroft's share of this market prior to the merger was 56 per cent by volume and [X] per cent by revenue. Given the lack of customer switching in the market in recent years (see paragraph 7.13), the long-standing relationships between maintenance providers and customers (see paragraph 7.9) and also given the absence of scale entry or expansion by competing maintenance providers, we infer that Marcroft's leading position in the market has been maintained at around these levels for at least the last three years, and probably much longer.⁶⁰ Only one other company in the market had a market share of more than 5 per cent: Wabtec, with a market share of 34 per cent by volume and [X] per cent by revenue. [X]
- 7.25 Marcroft provided a substantial proportion of the maintenance services for seven of the ten largest customers (by maintenance expenditure in 2005) and 13 of the top 20 customers. Of the remaining seven customers in the top 20, five were served by Wabtec, one by Bombardier (which was in fact Bombardier's sole freight customer) and one by EWS. Marcroft's large market share compared with that of Wabtec, and to all the other companies in the relevant market, and its continuing pre-eminent position in providing maintenance services to the largest users of third party wagon maintenance services, led us to believe that Marcroft should, before the merger, have had the ability to raise its price independently of other firms, and that accordingly Marcroft would have enjoyed a degree of market power.

Other factors affecting market power

- 7.26 We considered, in line with our guidelines (as set out in paragraph 7.23), whether there were any features of the market which would affect Marcroft's ability to exercise a degree of market power that we would expect to be associated with its large market share both in absolute terms and relative to its competitors.
- 7.27 We saw no evidence that the financial costs of switching were high. However, we noted customer concerns about service quality (see paragraph 7.53) and that wagon maintainers tended to have long-established relationships with customers and that there was only a very limited amount of switching in the market (see paragraphs 7.11 to 7.14). And, as noted in paragraph 7.163, we concluded that there was a risk associated with switching, especially to a new maintenance provider or to a small provider without a track record of handling large contracts.
- 7.28 Moreover, many customers stated that a key requirement in a maintenance provider is that they have sufficient scale to provide national coverage of maintenance

⁵⁹See discussion of market power in *Merger References: Competition Commission Guidelines, (CC2)*, 'Market power', page 11.

⁶⁰EWS argued that Marcroft had not had the largest market share in third party wagon maintenance for long, as prior to the MBO in 2004 Marcroft's maintenance of the VTG fleet had been in-house maintenance and therefore outside our market definition. EWS argued that this meant that prior to the MBO the third party market was smaller and Wabtec had a market share of more than 50 per cent of this smaller market. We found this argument unconvincing: the number of wagons maintained by Marcroft before and after the MBO had not changed materially as a result of the transaction. Further, before, during and after its acquisition by VTG, Marcroft was a third party wagon maintainer. We also noted that before and after the MBO maintenance of VTG's wagons was contracted to Marcroft, leaving them in effectively the same position as when Marcroft had been owned by VTG.

services, through a combination of manned outstations and/or mobile maintenance units (see paragraph 7.41). As noted in paragraph 7.49, some of the largest users of third party wagon maintenance have indicated that, of the third party maintenance providers, only Marcroft and Wabtec are able to provide sufficient coverage to meet their requirements. And, as noted in paragraph 7.51, we believed that only Marcroft and Wabtec were able to offer a national service for customers.

- 7.29 Therefore it did not appear that the threat of customers switching wagon maintainers was sufficient to reduce Marcroft's market power below the level we would expect to be experienced by a company with such a large market share.
- 7.30 We also considered whether threat of entry into the market would have affected Marcroft's ability to exercise market power. We concluded that there are barriers to entry and expansion, some of which would appear to be significant (see paragraph 7.166). Moreover, we concluded that the wagon maintenance market was an unattractive one to enter (see paragraph 7.140). Whilst there has been some recent small-scale entry (see paragraph 4.19), there has been no new entry or expansion on a scale sufficient to compete for larger contracts, and we do not expect such entry or expansion in the near future (see paragraph 7.166). Therefore it did not appear that the threat of entry was sufficient to reduce Marcroft's market power below the level we would expect to be experienced by a company with such a large market share.
- 7.31 We also considered whether customers could exercise countervailing buyer power, affecting Marcroft's ability to exercise market power. We concluded that the scope for customers to exercise buyer power was limited (see paragraph 7.179), so it did not appear that this was sufficient to reduce Marcroft's market power below the level we would expect to be experienced by a company with such a large market share.
- 7.32 Our analysis led us to believe that Marcroft's ability to exert the level of market power which might be expected due to its large market share both in absolute terms and relative to its competitors would not be materially affected by any of the factors set out in our guidelines, particularly given the lack of alternative maintenance suppliers with the ability to meet the requirements of large customers (see paragraph 7.51).
- 7.33 We therefore concluded that Marcroft, before the merger, had the ability to raise prices independently of other parties (see paragraph 7.25). Marcroft told us that it had tried, but failed, to raise prices to customers. EWS told us that Marcroft had been unable to raise prices because the market was fiercely competitive (something which Network Rail also told us; VTG also told us that it thought the wagon maintenance market was competitive and that Marcroft was constrained from raising prices prior to the merger), noting that, in its view: switching costs were low and that there were alternative suppliers of the relevant maintenance services; some customers could move to self-supply in response to a price rise; barriers to new entry in the light in-field maintenance business were low, facilitating easy entry in response to a price rise; and customers were able to exert a significant degree of buyer power in negotiations. Former Marcroft shareholders told us that they had attempted to raise prices. Davis told us that competition had prevented it from raising prices. It subsequently told us that it was sure that Marcroft could have raised prices. EWS told us that it was not possible to conclude, on the balance of probabilities, that Marcroft had pre-merger market power.
- 7.34 In order to assess Marcroft's statement that it had tried to raise prices, we asked Marcroft for evidence that it had lost contracts because it had pushed too hard for price rises. Marcroft provided us with evidence which it said showed that Marcroft did not have market power. We were given 13 examples relating to nine users of wagon maintenance services from 2001 to the present. However we did not think that all of

these examples were indicative of failed attempts by Marcroft to raise prices in the relevant market:

- examples relating to four maintenance users were examples of Marcroft failing to win a tender process for either components, new wagons or for wagons where another company was the incumbent maintenance provider (and it was not clear in every case whether the tender was lost on price or on other grounds);
- one example appeared to show Marcroft successfully rebuffing a request for a reduction in the amount to be paid for certain work;
- one example showed Marcroft successfully negotiating a price rise for 2006 of [X] per cent with a customer. Although the price rise started four months later than Marcroft wanted, the level of the price increase was higher than Marcroft initially sought to compensate for its later start. The increase followed a [X] per cent price increase in 2005. Another example about the same customer was a Marcroft internal email from 2001 that referred to the tough negotiating reputation of a new buyer;
- one related to paint spraying work, which is not an activity within the relevant market for this inquiry. Although the customer believed the price was too high, it nevertheless offered to send six wagons as a trial run to see what could be achieved on price.
- Marcroft told us that another customer had not accepted a price increase in the last two years, and Marcroft was only able to achieve very limited price increases on certain categories of labour costs in 2003. Other information submitted by Marcroft, however, showed that the base labour rate charged to this customer increased in 2004 and the premium time labour rate increased by over [X] per cent. We understand that further price increases have been proposed by Marcroft and are being discussed at present. Handwritten notes were also provided from a meeting with the same customer in 2005 where, because of an issue related to high costs associated with brake block wear, the customer threatened to tender its business unless a satisfactory agreement could be reached to share the costs with Marcroft. However, in the same notes, the customer later said that it did not want to go out to tender, it received a good service from Marcroft and it wanted to continue trading with Marcroft (though people within the customer's company who were not as close to the Marcroft work as he was wanted to market test). It seems to us that the customer was simply trying to push Marcroft to see what it could achieve. The final agreement on this issue showed Marcroft agreeing to absorb only around [X] per cent of the increased brake block costs, with the customer assuming the rest.
- The remaining three examples appeared to be cases where Marcroft lost business through competitive tenders where it had previously been the maintenance provider. However, in one case, in July 2002, Marcroft quoted for a two-year contract starting in September 2002 for a total of 531 wagons (of which 280 were already maintained by Marcroft). In late January 2003 Marcroft sought to raise its prices (attempting to increase base labour rates by some [X] per cent over those set out in the tender). After extensive discussions with the customer over the nature of the increases requested the business was placed with Wabtec in second quarter of 2003. In two other cases, one in 2004 for 95 wagons (of which 24 were already maintained by Marcroft) and one from late 2002 for 91 wagons (representing around 30 per cent of that company's wagons), Marcroft appeared to have lost a competitive tender process. The reasons for these three contract losses over the last five years, (which together

amount to [X] of Marcroft's present annual volume), were not given but there is no reason to assume that price was not a significant factor. We also note that one of these customers has since returned to Marcroft. That customer recently placed 100 per cent of its business with Marcroft, though we noted that despite losing the maintenance contract for a time, the amount of revenue Marcroft earned from that customer increased each year from 2003 to 2005.

- 7.35 In summary the 13 examples discussed in paragraph 7.34 that Marcroft provided showed that at most only three are examples that may suggest Marcroft lost business over price in the last five years. We did note that the evidence referred to in paragraph 7.34 showed that Marcroft sometimes failed to raise prices, and had lost some competitive tenders. We consider that a firm with market power will be able to raise its prices independently of other firms, at least to some extent. However, this does not imply that there will be no loss of business whatsoever in response to such a price increase. While we noted Marcroft's difficulty in raising prices, we note in paragraph 7.89 our belief that EWS's ownership of Marcroft would give it financial stability it had previously lacked, and management that would be better able to exploit Marcroft's market position.
- 7.36 We were therefore content that the evidence on limited price increases and the loss of some tenders was not inconsistent with Marcroft possessing market power. On this limited amount of evidence spread over a long period we did not find that Marcroft had tried but failed to raise prices to such an extent as to cast doubt on our assessment that Marcroft had a degree of market power prior to the merger.
- 7.37 We considered the arguments presented by EWS and Marcroft (as set out in paragraph 7.33) that Marcroft did not have pre-merger market power. We noted the views of EWS and Network Rail that the market was fiercely competitive. However, as noted in paragraphs 7.11 to 7.14, we found there had been limited switching by customers even though switching costs appeared not to be particularly high. This, and the presence of only two wagon maintenance companies (Marcroft and Wabtec) with substantial market shares (see Table 6) led us to conclude that the market was not fiercely competitive. Additionally, we did not think that there were many wagon maintenance companies that could reasonably be expected to be able to fulfil the larger maintenance contracts (see paragraph 7.58).
- 7.38 We concluded that Marcroft's market share before the merger had been large both in absolute terms and relative to Wabtec and its other competitors in the relevant market and that it had held a leading position in the market for some time. We concluded that none of the factors set out in our guidelines affected materially Marcroft's ability to exercise the degree of market power that its market share might be expected to bring. Similarly, we concluded that none of the points raised by EWS and Marcroft persuaded us that Marcroft's ability to exercise the degree of market power was any less than suggested by its high market share. This therefore led us to believe that Marcroft had a degree of market power.

Alternative suppliers to Marcroft

- 7.39 Having considered Marcroft's market position in relation to the factors set out in our guidelines, we considered other factors relevant to this case. We looked at whether, despite Marcroft's large market share, customers of wagon maintenance had sufficient alternatives. We assessed whether this was the case, considering two factors: first, whether customers in the haulage market required national coverage, and secondly whether there was any alternative to Marcroft to provide this service.

- *Requirement for national coverage*

- 7.40 For wagons making regular point-to-point journeys, maintenance locations at one or both ends of the journey (often provided by the customer) accompanied by appropriate mobile support may be sufficient to provide an effective maintenance service. For these customers, national coverage from a wagon maintainer is unlikely to be required; regional coverage should suffice. However, for wagons that are used on a number of different routes (rather than travelling on a single point-to-point route), and those travelling point-to-point over large distances, there is clear evidence of a strong customer requirement for access to a national network of outstations with maintenance teams to work at those outstations (through a permanent presence at an outstation or mobile teams servicing several outstations, depending on the circumstances), so that wagons can be maintained and repaired when and where necessary and without undue delay.⁶¹
- 7.41 EWS's main rivals in the haulage market all operate over large distances across the country. Moreover, at least one of them (Freightliner) operates wagons on a number of different routes (though EWS disputed that Freightliner's wagons operate on anything other than point-to-point routes). Two of them told us that they required national coverage from a wagon maintainer (as did a number of other customers of wagon maintainers).⁶² A [redacted] company [redacted] told us that it required national coverage from an outstation business to service its customers and deal with breakdowns, though it had used a small wagon maintenance provider on occasions for running repairs when the wagon was in a suitable location for that maintenance provider.
- 7.42 EWS told us that national coverage could be achieved through using mobile maintenance engineers to travel to unmanned maintenance sites. It also told us that the need for national coverage was no more than a preference for some customers, in that they could source their needs on a regional basis from different maintainers, that all wagons have a regular operating base at which maintenance can take place, and that the need for a national service to cater for unforeseen breakdowns was vastly overstated because national coverage was only needed for unforeseen breakdown repairs en route, such emergency maintenance was extremely rare, and that six parties had confirmed that such maintenance needs could be serviced by maintainers on an ad-hoc or call-out basis or on a self-supply basis. EWS also told us that Freightliner's evidence on remedies undermined its assertion that it needed national coverage, as it had suggested a strong interest in acquiring a particular outstation facility where it could service much of its fleet.
- 7.43 As noted in paragraph 7.41, several customers we spoke to told us that they did require national coverage from a single maintenance provider,⁶³ though we also noted that some smaller customers said that they did not require national coverage. Further, we received evidence from a [redacted] company that 12 per cent of the in-field maintenance events on its wagons in 2005 (amounting to over [redacted] events) were not planned and were undertaken outside the wagon's registered maintenance location.

⁶¹See, for example, *Submission from Freightliner, 26 April*, paragraph 3.2, *Summary of a hearing with Direct Rail Services*, paragraphs 4 and 8, and *Summary of a hearing with Bombardier Transportation*, paragraph 6'

⁶²See, for example: *Summary of a hearing with Direct Rail Services*, paragraph 4; *Summary of a hearing with VTG*, paragraph 11; *Summary of hearing with Network Rail*, paragraph 6; *Submission from Freightliner, 28 February*, paragraph 4.1. Another customer of haulage companies we spoke to (BP Oil) also told us that it required national coverage for its wagon fleets.

⁶³These included Freightliner. We noted EWS's argument in paragraph 7.42 about Freightliner's interest in a particular outstation. However, we also noted that Freightliner's comments were made during a remedies hearing during which it said that, whilst it was interested in acquiring the site in question, it did not consider that this would remedy the SLC and adverse effects of the merger. Freightliner did say that acquiring this facility would allow it to conduct much of its own wagon maintenance and that this would make it less reliant on an EWS-owned Marcroft post-merger should the merger be allowed to proceed. We were content that this did not contradict Freightliner's position that it required national coverage from a wagon maintainer.

Marcroft told us that it had conducted only around [X] maintenance events for that company, and we noted that Marcroft did [X]. We were unable to resolve the difference in number of maintenance events quoted by the two parties, but suspected it arose from what each party considered to be a maintenance event. Evidence from other companies indicated that the proportion of breakdowns or wagon failures was smaller but still a significant issue. One company told us that it typically had one or two wagon failures in transit a month. Another suggested that 1 or 2 per cent of wagons were out of use because of maintenance problems at any one time. A third user of wagon maintenance services told us that breakdowns were rare, typically one or two a year.

- 7.44 When there are unplanned maintenance events, haulage companies need a rapid response and are unlikely to want to take up time when the event occurs identifying a suitable maintenance company and negotiating with it to go out and repair a vehicle. Instead, they are likely to need to rely on their maintenance provider, or, if it is unable to offer an adequate service, appoint one or more other maintenance providers to deal with such situations.
- 7.45 We noted EWS's comment that all wagons had a registered base, and that this was the location where the vast majority of a wagon's maintenance was carried out. However, we also noted that a wagon can be maintained at any suitable registered maintenance location; maintenance is not restricted to a wagon's registered maintenance location. In this respect we noted evidence from Marcroft that it had maintained wagons for one of its main customers at 25 different sites in the past year.
- 7.46 There is a class of small customers for whom regional maintenance coverage would probably suffice. But for the majority of the market, including EWS's competitors in the haulage market, we did not accept EWS's view that national coverage was only a preference.
- 7.47 Similarly, we did not think that, for customers requiring national coverage, sourcing on a regional basis would be either viable or acceptable. We did note that one end-user company tended to award maintenance contracts for particular fleets of vehicles. A company that did have maintenance contracts with more than one service provider explained that it did so for historical and customer-specific reasons and told us that about 90 per cent of its work was carried out by one maintenance provider. A wagon-leasing company told us that it thought that it could operate with more than one maintenance supplier, though it would prefer not to.⁶⁴ However, in our view, splitting light in-field or SDG maintenance could only be achieved if wagons were predictably following certain routes and maintenance providers could be assigned particular flows. This would be possible, though administratively more expensive for the haulier. However, for companies whose wagons move around on a number of different routes this would be more difficult. Moreover, it would require smaller maintenance companies to work together to fulfil the contract. We were told that a few smaller third party maintenance providers had in the past tried to group together to offer national coverage, but this had never materialized because of disagreements between the companies involved, centred on the number of wagons in different parts of the country. It was suggested to us that the same issues would arise if this was attempted again, that there are fewer maintenance providers now than when this was looked at before, and in particular that there was a lack of small maintenance providers in the South of England.

⁶⁴Summary of a hearing with VTG, paragraph 11.

7.48 We concluded, therefore, that some of Marcroft's large customers, including EWS's rivals in the haulage market require national coverage. We also concluded that this coverage needs to be provided by one supplier, and that alternative methods of providing coverage suggested by EWS would not comply with these customers' requirements as to how maintenance should be provided and managed. We then considered who could offer that service.

- *Wagon maintainers able to offer national coverage*

7.49 Several customers⁶⁵ (who together operate over 5,000 wagons which rely on third party wagon maintenance) told us that only Wabtec and Marcroft had the geographic scope to service their fleets: as their wagons travelled throughout Great Britain, maintenance providers needed to be able to provide maintenance wherever it was needed. The third largest wagon maintenance provider, Davis, told us that it had the capability to expand and take on larger maintenance contracts.⁶⁶ However, it also told us that Marcroft and Wabtec were the only wagon maintainers with a national presence, and that it was aware of tenders for maintenance contracts requiring national coverage for which it had not been invited to tender. Similarly, Steele only has a small share of the wagon maintenance market and, as noted in paragraph 4.17, told us that it could not at that time offer light in-field maintenance services on a national basis.

7.50 Transfer of a workforce between employers as a consequence of TUPE legislation does not appear to us to be sufficient to overcome the barrier to small maintenance companies winning large contracts (see paragraph 7 of Appendix F).

7.51 On balance, the evidence led us to believe that only Marcroft and Wabtec are able to offer a national service for customers.

- *The position of Wabtec*

7.52 Wabtec is Marcroft's closest competitor in wagon maintenance. It has, for example, just won a contract to maintain wagons for Network Rail, continuing its relationship with that customer. However, we note that this contract forms the core of Wabtec's wagon maintenance work and we judge that it needed this contract to remain of a viable size to continue profitably in the wagon maintenance market. We noted in paragraph 4.15, that Wabtec now generates a significantly greater turnover in passenger carriage maintenance than in wagon maintenance. VTG and another wagon maintenance customer told us that they believed that Wabtec was now focusing on passenger carriage maintenance work, and one of them said that it thought Wabtec was no longer interested in supplying them with wagon maintenance services. However, Wabtec told us that it remained focused on this business, that it had proved to be competitive on price, and enjoyed higher margins because of its low cost base and efficiency. We received a representation that Wabtec charged higher prices. One maintenance customer told us that, in quoting to carry out wagon maintenance, Wabtec had been very considerably more expensive than Marcroft. Wabtec disputed this, arguing that it had won tenders by offering the best price and service. On balance, we do not consider that Wabtec will offer any stronger constraint on Marcroft's pricing that it has hitherto. It may be expected to continue

⁶⁵See, for example: *Summary of a hearing with Direct Rail Services*, paragraph 4; *Summary of a hearing with VTG*, paragraph 11 (VTG also said that it would be possible to appoint more than one smaller maintenance provider to meet its needs, though this would involve VTG using more field inspectors and taking more control over the contracts in its offices); *Summary of hearing with Network Rail*, paragraph 6; Submission from Freightliner, 28 February, paragraph 4.1.

⁶⁶*Summary of staff hearing with W H Davis Ltd*, paragraph 12.

bidding for maintenance contracts but on balance we took the view that Wabtec is likely to seek higher margins than its competitors and therefore be a more costly option for customers.

7.53 Evidence we received suggested that most of EWS's haulage competitors did not consider that Wabtec was a suitable alternative for their wagon maintenance requirements. [X] we noted Wabtec's comments suggested that genuine problems had at that time been raised (and that Wabtec said it had addressed the underlying issues). We were satisfied that these companies still did not see Wabtec as a suitable alternative maintenance provider.

- *Self supply as an alternative*

7.54 EWS told us that other haulage companies could turn to self supply relatively easily in response to a price rise or decline in service quality, and argued that Freightliner already has a share equating to 7 per cent of in-house and open market services. EWS argued that Freightliner's strong position in the haulage market, generating approximately £250 million of sales, gave it the resources and scale to expand its in-house services. The recent purchase of a site from LNWR by Freightliner and its attempt to recruit maintenance staff is seen by EWS to signify that both acquiring facilities and employing appropriately trained staff cannot be held as a barrier to developing in-house services. Furthermore, EWS maintained that if EWS were to raise prices or act anti-competitively, then in-house services at Freightliner or another haulage company could pick up third party maintenance business to improve economies of scope yet further. EWS also suggested that short notice periods written into maintenance agreements between haulage companies and Marcroft suggest that these companies believe it is relatively quick and easy to switch. EWS noted that DRS carried out light in-field maintenance on the wagons it owns (relying on Marcroft for light in-field maintenance of the wagons it leases) and argued that this contradicted our view that there is a minimum efficient scale of a self-supply wagon maintenance operation. DRS told us that it performs its own wagon maintenance in the nuclear market due to a requirement for specific quality and control.

7.55 Marcroft expressed the view that the freight operating companies could 'react and create an alternate supply chain' in a very short time, possibly days.

7.56 We considered whether haulage companies could quickly, easily and economically switch to self-supply of the work currently undertaken by Marcroft. We noted that there are economies of scale in maintaining wagons, and that national coverage could not be provided effectively and efficiently from only one single maintenance location. Provision of national coverage would require investment to establish a presence at a number of outstations. Therefore, it is doubtful that any haulage company requiring national coverage, other than EWS, would have enough wagons to carry out its own maintenance cost-effectively, without also needing to carry out third-party maintenance in order to generate additional revenue to cover costs. We considered whether customers of third party wagon maintenance services could switch to self supply in paragraphs 5.19 to 5.22 and identified substantial cost and operational obstacles to such a switch. In particular, we noted in paragraph 5.20 that firms that did some wagon maintenance in-house did so for specific operational reasons; that they saw substantial cost and operational obstacles to switching to in-house maintenance for the remainder of their fleets; and that those who would consider doing so would only do so in extreme circumstances. We therefore concluded in paragraph 5.22 that in-house and third-party provision of wagon maintenance were not in the same market. They did not therefore act as competitive constraints on each other. We asked EWS's rivals in the haulage market whether they had considered bringing maintenance in-house:

- DRS, which does already carry out some in-house maintenance (see paragraph 4.27), told us that it had not carried out a quantitative assessment of the costs or benefits of undertaking further wagon maintenance in-house, though there had been some recent internal discussions about the possibility of bringing maintenance in-house. It said that it had no current plans to undertake on an in-house basis the wagon maintenance undertaken by Marcroft. DRS also told us that although it was a small company, it needed national coverage for wagon maintenance;
- GB Railfreight told us that it had never considered bringing wagon maintenance in-house, as this was not part of its core business; and
- Freightliner is the largest of EWS's rivals in the haulage market. It might therefore be expected to be best placed to switch entirely to in-house maintenance if switching is feasible for haulage companies, particularly as it already undertakes in-field maintenance on its intermodal fleet (see paragraph 4.26). Freightliner told us that, after it heard about EWS's proposed acquisition of Marcroft, it had looked into the possibility of bringing the maintenance of its heavy haul wagons in-house. [REDACTED] In considering this possibility it looked at various issues, including the need for an appropriate workshop location and costings of bringing maintenance in-house. [REDACTED] Freightliner also looked at acquiring a suitable workshop location. It told us that it could take up to a year to make a suitable workshop location ready for wagon maintenance use. [REDACTED] It has since acquired LNWR's Midland Road site in Leeds, but it told us that it was using this site solely to optimize its locomotive maintenance (though Freightliner already uses two sidings next to this LNWR site as a site for Marcroft to do some maintenance on its coal wagons, which make up the majority of its heavy haul fleet). Freightliner had not conducted a full project plan for bringing its heavy haul maintenance in-house but had produced costings which showed that carrying out this maintenance in-house would be more expensive than using Marcroft, [REDACTED]. Freightliner told us that it could move to in-house wagon maintenance of much, but not all, of its fleet, if it acquired the Storrs Hill maintenance facility near Wakefield, with associated staff and assets. However, it noted that bringing maintenance in-house would be a more expensive option for it, that the Storrs Hill facility had not been, and was not, available for it to acquire, and that it would still need to contract out wagon maintenance for about [REDACTED] per cent of its Heavy Haul fleet, for which it expected it would still need to rely on Marcroft. It told us that it did not think that such an arrangement would remedy the SLC and adverse effects arising from the merger, but would lessen Freightliner's reliance on an EWS-controlled wagon maintenance provider. We concluded that Freightliner had looked seriously at the possibility of bringing this maintenance in-house because of the merger, but had failed to find a suitable workshop location (which it considered crucial to such a strategy and which it told us could take up to a year to make ready for use⁶⁷), and had also found that it would be more expensive than the maintenance service currently provided by Marcroft.

We consider that the evidence and analysis on this point shows that haulage companies could not quickly, easily and economically switch to self-supply of the work currently undertaken for them by Marcroft.

⁶⁷Freightliner told us that it needed a workshop to undertake 'heavy' maintenance, though not GR work which it tended to put to tender, and that the incidence of such work would increase as its relatively young heavy fleet aged. We noted that this was a different approach from that adopted by EWS which undertook the vast majority of its work in-field and had closed its workshops. We also noted that EWS did not regard a workshop as an essential component to a wagon maintenance operation, though we did not consider that this meant that Freightliner's view was not equally valid.

7.57 We did not think that leasing companies would find it any more attractive—indeed one leasing company [REDACTED], and another told us that, whilst it could be made viable, it would be a major management change and not something to take on lightly.⁶⁸

- *Conclusion on alternative suppliers to Marcroft*

7.58 We concluded, therefore, that EWS's main competitors in the haulage market required national coverage. We also concluded that this left them with only two wagon maintenance providers that could offer this service—Marcroft and Wabtec. Further, we concluded that two of EWS's competitors in the haulage market considered that only one company, Marcroft, could provide wagon maintenance services to the level of satisfaction they required.

Conclusion on market power

7.59 As noted in paragraph 7.38, our analysis of Marcroft's overall market position led us to believe that Marcroft had a degree of market power prior to the merger. And as noted in paragraph 7.58 we concluded that EWS's competitors in the haulage market required national coverage, that this left them with only two wagon maintenance providers that could offer this service, and that two of EWS's competitors in the haulage market considered that only one company, Marcroft, could provide wagon maintenance services to the level of satisfaction they required. Taking all of these factors into account we conclude that Marcroft did have a degree of market power prior to the merger.

Effects of the merger in the wagon maintenance market

Non-coordinated effects in the wagon maintenance market

7.60 We looked first at the effects of the merger in the rail freight maintenance market—in particular whether it would allow the merged company to take actions, such as raising prices, independently of the actions of other maintenance providers (non-coordinated effects).

7.61 The merger brought together the largest supplier of third-party wagon maintenance services (Marcroft) with a supplier which only had two contracts for third-party maintenance (EWS). This represented a total share of the supply of maintenance to third parties of [REDACTED] per cent by revenue (or 59 per cent by light in-field maintenance market shares). The related HHI for the supply of maintenance to third parties would increase from 4,752 to 4,855 on the basis of the revenue data (or from 4,266 to 4,545 on the basis of light in-field maintenance market shares). As noted in paragraph 7.17, HHIs of this magnitude are indicative of a highly concentrated market.

7.62 EWS told us that the merger did not give rise to competition concerns in this market. It told us that it had not exercised a competitive constraint on Marcroft prior to the merger because its high [REDACTED] costs prevented it from putting in competitive tender quotes, but that other maintenance providers (in particular Wabtec, but also companies such as Davis and Steele) did offer a competitive constraint. EWS also suggested that customers could switch to self-supply of maintenance services. Most customers we spoke to did not mention EWS when asked to list possible alternative suppliers of wagon maintenance suppliers.

⁶⁸Summary of a hearing with VTG, paragraph 11.

- 7.63 Several customers we spoke to expressed no concerns about the merger.⁶⁹ They told us that Marcroft had been in financial difficulties and the merger allowed it to continue operating. Some of them told us that the merged entity had reassured them that they would not face price rises as a result of the merger. One customer said that it had no concerns because it believed that, as long as staff working on its wagons could transfer across to a replacement maintenance provider under the TUPE regulations, there were alternative suppliers it could use.
- 7.64 One customer [redacted] told us, after our provisional findings were published, that it valued the one-stop shop offered by Marcroft and was concerned that, if our provisional findings became final, it would be disadvantaged by having to agree different contracts for in-field and workshop maintenance, and it would not have priority for workshop availability. It also told us that its past dealings with alternative wagon maintainers had not convinced it that its fleet would receive the same level of service with them as was currently achieved with Marcroft.
- 7.65 Another customer (Mendip Rail) had no concerns about the merger, but was concerned that if the provisional findings stood, the separation of the workshop and outstation businesses would make its life harder, costlier and more time consuming, and less competitive than the current single source for these services (though it noted that it negotiated its haulage, maintenance, parts supply and repair contracts separately). It suggested that the biggest risk to separating the outstation and workshop businesses was the possible loss of engineering support for the outstation business.
- 7.66 A third customer, who expressed no concerns about the merger, responded to our provisional findings report to express concern about the possible transfer of Marcroft's nationwide coverage, via its network of outstations, and 24-hour engineering support in the event of a rail emergency, to another maintainer. It also suggested that transfer of the outstation business might be difficult, [redacted]. It suggested that there was no guarantee that a customer would accept an alternative arrangement such as subcontracting to another workshop, and this would undermine the value of the business being divested.
- 7.67 On the other hand, some concerns were expressed about the effects of the merger. Three main issues were raised. Three of Marcroft's maintenance competitors were concerned that EWS could disguise maintenance charges through bundling them with haulage charges, preventing other maintenance providers from being able to win that work; the ORR⁷⁰ noted that the merger gave EWS greater potential for bundling services to the detriment of other haulage companies that could not offer a comparable package of haulage and maintenance services to customers who own their own wagons at a comparable price. One maintenance provider considered that EWS could exclude other maintenance providers from gaining access to maintenance locations. Another maintenance provider was concerned that the merger of what it considered to be the two largest players in the market would raise barriers to entry and expansion, and would significantly increase the purchasing power of the merged entity.

⁶⁹See, for example: *Summary of a hearing with BP Oil Limited*, paragraph 8; *Summary of a hearing with VTG*, paragraph 12. Moreover, one customer who had not placed work with Marcroft over the last two to three years expressed no concern about the merger—see *Summary of hearing with Network Rail*, paragraph 8, a competitor of Marcroft expressed no concern about the merger as long as Marcroft continued to be run as an independent entity—see *Summary of a hearing with E G Steele*, paragraph 24, and two former Directors of Marcroft and the company which advised Marcroft on the sale also expressed no concern about the merger.

⁷⁰See, for example: Submission from Arlington Fleet Services Limited, and *Summary of hearing with Arlington Fleet Services*, paragraph 8; Submission from WH Davis; and *Summary of a staff hearing with WH Davis*, paragraph 22, *Summary of a hearing with the Office of Rail Regulation*, paragraph 15.

- 7.68 Concerns were also raised by some customers of wagon maintenance providers. Most of these concerns are set out in the section looking at the effects of the merger on the haulage market (see paragraphs 7.80 to 7.85). One customer was concerned that the merger would reduce competition in the maintenance market, and prevent the industry from becoming more efficient.
- 7.69 As set out in paragraph 5.22, we concluded that, prior to the merger, EWS and Marcroft were not in the same market. EWS was not, therefore, imposing a direct competitive constraint on Marcroft, or any other third-party maintenance provider. As set out in paragraph 6.29, we concluded that the relevant counterfactual for this investigation was that Marcroft's in-field maintenance business would remain active, probably in the hands of another company. EWS's apparent lack of competitive pricing, and its low market share in wagon maintenance, indicated to us that EWS was unlikely to provide a competitive constraint on Marcroft under the counterfactual.
- 7.70 We found, therefore, that the merger did not result in the loss of a competitive constraint on Marcroft. Similarly, we found that the merger did not bring about an immediate increase in Marcroft's market power in the wagon maintenance market. We concluded, therefore, that the merger did not give rise to non-coordinated effects in the wagon maintenance market.

Coordinated effects in the rail freight maintenance market

- 7.71 In certain concentrated markets, the actions of individual firms can have identifiable effects on their competitors such that firms recognize their interdependence⁷¹ and their common interest in avoiding mutually destructive price cuts. Such 'coordinated effects' may be sufficient to deter a cut in price.⁷² We saw no evidence to suggest that coordinated effects were present in the market prior to the acquisition. Neither did we see any evidence to suggest that the acquisition of Marcroft by EWS would increase the likelihood of coordinated effects. Rather, the post-merger market appeared to be best characterized as one in which there is one large firm, the merged entity, with market power, a medium-sized competitor (Wabtec), and a few smaller firms who would not be expected to provide a significant competitive constraint upon EWS's post-merger activities. Therefore, we concluded that there did not appear to be the potential for horizontal coordinated effects to arise as a result of this merger.

Incentives to bundle maintenance and haulage

- 7.72 We considered the concern expressed by competitors that the merger would allow the parties to bundle services together. We noted that EWS had the ability to do this prior to the merger. The change caused by the merger would be that the merged entity would be able to offer a cheaper maintenance package within the bundled service as a result of using Marcroft to provide maintenance services. EWS may make a cost saving as a result, though it may not pass this on to customers in the form of lower prices. We saw no evidence to suggest that this would lead to higher prices or lower quality to customers (for example, as a result of forcing the exit of the merged entity's rivals in the maintenance market).

⁷¹Merger References: Competition Commission Guidelines (CC2), June 2003, paragraph 3.32.

⁷²Coordinated effects are described in more detail in Merger References: Competition Commission Guidelines (CC2), June 2003, paragraph 3.32 onwards.

Conclusion on effects of the merger in the wagon maintenance market

- 7.73 For the reasons set out in paragraphs 7.70 to 7.72 we conclude that the merger does not give rise to an SLC in the wagon maintenance market.

Effects of the merger in the haulage market

- 7.74 We then considered the effects of the merger in the downstream haulage market. Maintenance is an essential input for owners and users of wagons. EWS's ownership of Marcroft would mean that, after the merger, EWS would become a supplier of wagon maintenance services to its competitors in the haulage market. Therefore, the question arises as to whether, following the merger, EWS might increase the costs of its rivals in the haulage market, or disadvantage them in some other way. This might occur as a result of either:

- (a) reducing service quality. Many haulage contracts are time-critical, and failure to provide the service can quickly result in additional costs on the customer, potentially reducing the quality of service they can in turn provide to their customers. Whilst we do not believe that EWS would reduce the standard of repairs and maintenance work that Marcroft provides to EWS's rivals, the quality of service provided could be reduced without jeopardizing safety, for example by extending the time taken to conduct maintenance (by prioritizing the maintenance of EWS's wagons ahead of those of third parties), or increasing uncertainty as to whether maintenance will take place at the expected time, or will be completed within the timeframe specified. This would result in reduced availability of wagons, making it harder for customers to fulfil contracts with that number of wagons, or customers being uncertain when their wagons will be available, creating difficulty for haulage companies in bidding for contracts. In this respect, we note that most contracts are of an informal nature (see paragraph 7.9), limiting the scope for compensation if service quality reduces. (Marcroft told us that such informal contracts were often at the choice of customers who had proved resistant to its attempts to move to working on the basis of more formal agreements); or
- (b) increasing the prices that Marcroft charges to customers for wagon maintenance services (either all customers, or discriminating between those who use EWS's haulage services and those who do not, or between those who compete with EWS in the haulage market and those who do not).

- 7.75 In order to determine whether we should be concerned about these possible effects of the merger, we considered whether the merged entity would have the ability and the incentive to lower service quality, or raise prices (or do both) to EWS's haulage competitors.

The views of EWS

- 7.76 EWS told us that it had neither the ability nor the incentive to lower service quality or raise prices to its haulage rivals. On its ability to do this it told us that:
- to raise its downstream rivals' costs by a material amount would require an implausibly large increase in maintenance prices (because EWS said that wagon maintenance services accounted for no more than 0 to 10 per cent ([~~10~~]) of the overall cost of a downstream freight operating company);

- the merged entity had no ability to raise prices because of the competitive constraints imposed by other competitors, and the potential for new entrants and customers moving to self-supply;
- it would be economically irrational to do this on any significant scale, as it would result in underutilization of Marcroft wagon maintenance staff and the loss of valuable third party maintenance revenue; and
- the strategy would be at odds with EWS's stated intention to run Marcroft as an independent business. (Marcroft told us that following the transaction in November 2005 it had offered to put in place a contractual framework, with EWS's support, to protect the service levels it delivered to customers but that none took up the offer.)

7.77 EWS told us that it did not have any incentive to raise the costs of its rivals in the haulage market, because:

- maintenance costs were only a small proportion of haulage costs (see paragraph 7.76) and therefore any price rise would be insignificant;
- any attempt to raise rivals' costs would be disproportionately damaging to its reputation and business with those hauliers;
- it had not attempted to raise rivals' costs when providing other essential services to its competitors; and
- it had to retain Marcroft as an independent company in order to [REDACTED] (see paragraph 3.3).

7.78 EWS also told us that there were no customers or wagons at risk from the merger, as there were viable alternative maintenance sources for all customers (either other suppliers or self-supply).

The views of third parties

7.79 As noted in paragraph 7.63, several customers we spoke to (who are not competitors in the haulage market) expressed no concerns about the merger.

7.80 However, we received a number of other representations expressing concern about the effects of the merger for haulage and leasing companies. These covered a variety of issues. One [REDACTED] company initially said that it had no concerns about the merger. It said that if the merger did not take place, Marcroft might collapse leaving Wabtec with a monopoly position in the market. After publication of our provisional findings, however, it told us that it had minor concerns about the merger, when compared with the ongoing viability of Marcroft in the absence of the merger. It told us that it thought that our provisional findings should become final, and that it believed that the merger would result in higher prices and lower service quality for it.

7.81 Another [REDACTED] company said that if EWS were to restrict the availability of Marcroft for servicing third-party wagons this would remove 56 per cent of capacity compared with the situation in the absence of the merger. In such circumstances, Wabtec would offer the only alternative and would have an incentive to increase prices. It suggested that the merged entity could delay maintenance to its fleet, and alleged that [REDACTED]. Further, it said that the acquisition removed a source of competition compared with the situation in the absence of the merger, and that prices and quality would suffer as a result. It said that there were no other credible sources of maintenance, unless

Wabtec invested in its services. Switching therefore required a large lead time (as it was not clear that there was currently any maintenance provider suitable to carry out the work), which would adversely affect its business.

- 7.82 A third [redacted] company⁷³ said that the merged entity would have an incentive to delay the maintenance of its wagons. This would extend the downtime of its wagons and raise prices, and could quickly force it out of the consumer goods haulage market. It said that EWS would like to enter this particular market.
- 7.83 A [redacted] company told us that it believed it would suffer from significant cost inflation as a result of the merger because of the lack of an alternative maintenance supplier. In addition, it was worried that EWS, which was a competitor [redacted], would have access to data, including costs, relating to its fleet. It told us that it was worried that it would be subjected to increased maintenance rates (over and above those considered fair and reasonable) which could have an effect on the levels of service and cost they received from the [redacted] and from Marcroft. It told us that switching to an alternative maintenance supplier would be difficult, as the only other supplier with sufficient geographic spread was Wabtec, but it said that Wabtec was focusing its efforts on the passenger carriage maintenance market.
- 7.84 In response to our provisional findings, one customer of haulage services told us that, whilst it had not originally had concerns about the merger, the submissions to the inquiry, identifying the reliance on Marcroft by others involved in the haulage market, had raised its concerns. It concluded that the potential and likelihood for this to lead to a reduction in the overall ability of customers of the haulage market to operate in a truly competitive environment was evidently a real issue.
- 7.85 Finally, the ORR⁷⁴ told us it had not conducted an assessment of the rolling stock markets, nor had it received any competition complaints relating to wagon maintenance services. It noted that the merger led to EWS becoming vertically integrated and it would be supplying maintenance services to others active in the haulage market. While it recognized that the merged entity would have a general commercial incentive to utilize the capacity in the Stoke workshop, regardless of whether it was servicing competitors or not, it noted that, from a theoretical standpoint, an undertaking in a vertically integrated position may have greater incentive to raise prices or restrict output in the wagon maintenance market in order to foreclose a significant portion of a downstream market. It also told us that, bearing in mind EWS was the leading haulage operator in Great Britain, the acquisition could enable EWS to acquire or enhance further its market power in haulage markets by restricting the supply of maintenance services or access to sidings, since it would control a significant proportion of the market of an essential input (wagon maintenance).

EWS's ability to lower service quality or raise prices

- 7.86 We considered whether the merged entity would have the ability to lower service quality or raise prices to haulage companies. We concluded in paragraph 5.34 that the relevant product market for the merger was wagon maintenance services to third parties. Marcroft's market share in this market prior to the merger was 56 per cent by volume and [redacted] per cent by revenue (see Table 6). [redacted]

⁷³Summary of a hearing with Direct Rail Services, paragraph 15.

⁷⁴Submission from the Office of Rail Regulation, page 12.

- 7.87 We concluded in paragraph 7.58 that EWS's competitors in the haulage market required national coverage, that this left them with only two wagon maintenance providers that could offer this service, and that two of EWS's competitors in the haulage market considered that only one company, Marcroft, could provide wagon maintenance services to the level of satisfaction they required. We concluded in paragraph 7.59 that Marcroft did have a degree of market power prior to the merger.
- 7.88 As Marcroft had a degree of market power we concluded that it had the ability to raise prices above competitive levels.
- 7.89 We believed that bringing Marcroft under EWS's ownership would give it financial stability it had previously lacked, and management that would be better able to exploit Marcroft's market position. As we noted in the counterfactual that Marcroft's outstation business was likely to be sold (see paragraph 6.29), we thought it likely that Marcroft would also benefit in the counterfactual from greater financial stability and management better able to exploit this.
- 7.90 This led us to conclude, in turn, that the merged entity would have at least as much market power after the merger, compared with the situation in the absence of the merger, and that its enhanced financial stability and management would better enable it to use its degree of market power.
- 7.91 In order for EWS to have the ability to lower service quality to its competitors in the haulage market, it would be necessary for Marcroft to have a degree of market power. If EWS's competitors did have sufficient alternative wagon maintenance providers, they could switch to another provider if the level of service quality diminished.
- 7.92 Given Marcroft's degree of market power, we conclude that EWS's haulage competitors have insufficient alternatives to Marcroft for carrying out their wagon maintenance, and hence that EWS has the ability to lower service quality.
- 7.93 We concluded, therefore, that EWS has the ability to lower service quality and raise prices to customers in the haulage market.

EWS's incentive to lower service quality or raise prices

- 7.94 We then considered whether EWS had the incentive to reduce service quality and/or raise prices to its competitors in the haulage market.
- 7.95 Before the merger, Marcroft, like all maintenance providers, had the usual commercial incentives to operate to a service quality level such that it did not lose work due to poor service (for example, not starting or completing maintenance on time). Following the merger, however, lengthening the amount of time taken to maintain a wagon, respond to a maintenance need, or increasing the uncertainty as to whether maintenance will take place at the expected time, or will be completed within the timeframe, would have the effect of increasing the downtime of the wagons of customers who were EWS's competitors in haulage. We noted that EWS could lower service quality to selected customers—it did not have to lower service quality to all customers in order to lower service quality to its haulage competitors. Its competitors would be faced with higher costs—for example, through having fewer available wagons to do work at any given time, or not being able to run a timetabled train, which might result in financial penalties for missing delivery deadlines. It could also result in EWS's rivals losing haulage contracts—we were told that some haulage

companies could very quickly lose contracts for consumer goods haulage if they underperformed.⁷⁵ If contracts were lost, the haulier would suffer significant financial loss, which, especially for the smaller hauliers, could have a significant impact on their business and their reputation as a viable alternative to EWS. There would therefore be a clear incentive for the merged entity to lower the service quality standard in certain circumstances, allowing EWS to increase the costs of its rivals in the downstream market, or disadvantage them in some other way. This incentive is a result of the merger.

- 7.96 For the reasons set out in paragraphs 7.88-7.89, we concluded that EWS had the ability to raise prices. We considered if it had the incentive to raise prices. Having concluded that Marcroft did have a degree of market power, we believed that, after the merger, the merged entity would have the incentive to bid at higher rates for tenders (or to seek higher rates from existing customers) than would have been the case in the counterfactual. This is sometimes referred to as 'raising rivals' costs'.⁷⁶ The reasoning behind this is set out below.
- 7.97 We took as a theoretical example, a haulage rival of EWS for which Marcroft is the incumbent maintenance provider. Prior to the merger, that haulage operator's choice of Marcroft as its maintenance provider implies that Marcroft offered it a combination of price and service quality that it preferred above all other offerings available from alternative maintenance providers. Following the merger, if Marcroft tried to increase the price that it charged the haulage operator for maintenance services, the haulage operator would then be faced with a choice between accepting the price increase or switching to an alternative maintenance provider (we concluded in paragraph 7.56 that haulage companies could not quickly, easily and economically switch to self-supply of the work currently undertaken by Marcroft). If it accepted Marcroft's higher price, then this would result in increased revenue for Marcroft and higher maintenance costs for EWS's rival in the haulage market, thereby reducing that rival's competitiveness against EWS in the provision of haulage services. If, however, the haulage operator wished to avoid paying the higher price requested by Marcroft, it would have to choose an alternative maintenance provider which it had not chosen prior to the merger. This implies that the haulage operator would either have to pay a higher price, or accept a reduced service quality, compared with the 'most-preferred' package previously purchased from Marcroft prior to the merger. Again, this would increase the costs of EWS's rival in the haulage market, thereby reducing that rival's competitiveness. In this way, the merger provides the combined EWS and Marcroft with an incentive to raise prices to EWS's haulage rivals in the downstream market following the acquisition.
- 7.98 This strategy would mean that the merged entity would be pricing at a level at which it might expect to lose some market share in a small market (third party wagon maintenance, which, as noted in paragraph 4.8, was worth around £[£] a year). It would be doing this in order to protect or gain market share in the far larger haulage market (which, as noted in paragraph 4.4, was worth around £800 million a year), or raise prices in that market. We believed, therefore, that EWS would have the incentive to increase the price of Marcroft's maintenance offer to EWS's competitors in the haulage market. EWS's competitors, faced with increased prices, would have to either absorb the price rise and reduce their margins, or pass it on to customers and reduce their own competitiveness.

⁷⁵ Summary of a hearing with Direct Rail Services, paragraph 15.

⁷⁶ See, for example, *The Impact of vertical and Conglomerate Mergers on Competition*, available from the Europa website at: http://ec.europa.eu/comm/competition/mergers/others/merger_impact.pdf.

- 7.99 We considered EWS's arguments that it did not have the incentive or ability to lower service quality or raise prices, as set out in paragraphs 7.76 to 7.78.
- 7.100 On EWS's incentives to lower service quality, maintenance is a vital requirement for haulage companies, and so a small reduction in service quality would be expected to lead to a very significant increase in costs for EWS's downstream competitors, or would cause them to lose business. In a time-critical business, such as haulage, the ultimate customer is likely to move its business quickly from any haulage provider whose service quality deteriorates. On EWS's incentives to raise prices, as noted in paragraph 7.77 EWS suggested to us that the effect on its downstream haulage competitors of a rise in the price of maintenance would be minimal, as EWS estimated the cost of maintenance to equate to only 0 to 10 per cent ([REDACTED]) of haulage operating costs. Therefore, even a relatively significant increase in the price of wagon maintenance would only lead to a small percentage increase in costs for EWS's downstream competitors.
- 7.101 We also found that EWS would have an incentive to raise prices, because:
- any increase in costs for EWS's downstream competitors would be expected to reduce their ability to compete with EWS to some extent; and
 - other companies suggested to us that maintenance accounts for significantly more than 0 to 10 per cent ([REDACTED]) of operating costs (see Table 5).
- 7.102 On the merged entity's ability to lower service quality or raise prices, as noted in paragraph 7.59, we concluded that Marcroft did have a degree of market power before the merger. We were therefore satisfied that the merged entity did have the ability to lower service quality or raise prices. [REDACTED] We noted, therefore, that Marcroft's leading position may be expected to be consolidated and strengthened by the merger because it can be sure that its business base will be progressively enlarged by the addition of the EWS wagon fleet as a 'captive' customer. EWS told us that it intended to use Marcroft predominantly for component overhaul initially, but this did not change our analysis of how its business base would be progressively enlarged.
- 7.103 On the competitive constraints faced by the merged entity, as noted in paragraph 7.90, we concluded that Marcroft continued to have a degree of market power after the merger. We believed the strategy set out in paragraph 7.97 was an economically rational, and therefore likely, one. [REDACTED]
- 7.104 We accepted that EWS's stated intention was to run Marcroft independently, and we understood the need for Marcroft to be operated as a separate company to avoid [REDACTED]. However, we did not consider this to be a reason for EWS not to implement a strategy that would be economically advantageous to EWS as a whole, given that [REDACTED] would not prevent EWS acting in this way.
- 7.105 We concluded that EWS did have the incentive to lower service quality, and that this incentive was a direct result of the merger. On balance we also concluded that EWS would have the incentive to raise Marcroft's prices for wagon maintenance to EWS's rivals in the haulage market.

Would EWS lower service quality or raise prices?

- 7.106 Having concluded that EWS had both the ability and incentive to reduce the level of service quality and raise price to its rivals in the haulage market, we considered whether it was likely to do either. We concluded, on balance, that it would lower

service quality, at least to certain customers who were competitors of EWS, given the strong incentive to reduce service quality (as noted in paragraph 7.95), and the much greater size of the haulage market as compared to the maintenance market (as noted in paragraph 7.98).

- 7.107 We also considered that, on balance, it would choose to raise prices, given that if it did so it would either gain revenue at the expense of its competitors in the haulage market, or its competitors would have to accept higher prices or lower service quality from another supplier, putting them at a competitive disadvantage to EWS. Whilst the effect of raising prices might not be very large, the downside to EWS of doing so appeared to us to be minimal, [X] caused by customers switching to a higher priced or lower quality alternative [X] (see paragraph 7.24).
- 7.108 We believed that the merged entity had the ability to inflict damage on its competitors very quickly—many contracts for haulage are time-critical, and there was potential for some contracts to be lost if there was hold-up in deliveries (perhaps most notably in the haulage of time-critical consumer goods).⁷⁷ In light of this possibility, competitors may be faced with either taking a chance that the merged entity would not behave in this way, or changing maintenance provider at short notice, at which point the competitors would have to accept whatever price or service level they were offered, given their lack of time and alternative providers.
- 7.109 If a rival of EWS was unable or unwilling to use an EWS-controlled Marcroft for its wagon maintenance, because of a reduction in quality or because it was unwilling to take the risk of a reduction in service quality, Wabtec was its only alternative (as set out in paragraph 7.51). Wabtec would be the only independent provider of wagon maintenance services on a nationwide basis. In such circumstances we would expect Wabtec, despite its unattractiveness as a supplier to certain customers, to be able to use this position to its advantage, through raising prices. It would also have no incentive to improve or maintain levels of service quality, as there would be no competitive pressure on it to do so.⁷⁸
- 7.110 We considered EWS's arguments in paragraphs 7.76 to 7.78 which related to whether it would lower service quality or raise prices.
- 7.111 We considered EWS's claim that such action would be disproportionately damaging to its reputation, given that it obtains revenue from other services provided to competitors. We did not accept EWS's argument. We noted that there were mixed feelings about EWS among competitors and that there had been a number of complaints and commercial disputes. As a result of competitor complaints to ORR under the Competition Act, EWS had been the subject of four ORR investigations, three of which had resulted in no adverse finding against EWS and one of which had been active for over five years (see Appendix D). We also received forceful representations alleging misconduct on EWS's part from one of the companies EWS cited as both a competitor and customer whose custom it could not afford to lose by damaging its reputation. We were also given evidence of EWS's behaviour in respect of charging for access to sidings or track, and conduct during the handover of a haulage contract, from several other sources. We note that these are essentially anecdotal complaints, and that these latter complaints have not been put to ORR. Whilst we do not make any assessment of the merit of these complaints, it does appear to us that EWS's customers and rivals have had a number of disputes with EWS, which have left a degree of bad feeling among in particular EWS's customers

⁷⁷For example, *Summary of a hearing with Direct Rail Services*, paragraph 15.

⁷⁸We consider this to be the effect on customers of EWS's ownership of Marcroft rather than any interdependence between an EWS-controlled Marcroft and Wabtec, as would be the case in a market with coordinated effects.

and some of its key competitors, who might be disadvantaged as a result of the merger. In light of the incentives to disadvantage EWS's competitors in the haulage market (see paragraphs 7.95) and the bad feeling among some customers, on balance we do not believe that damage to EWS's reputation would provide a sufficient disincentive on EWS to engage in the above action.

7.112 We noted EWS's argument that there was no evidence that it had sought to raise haulage rivals' costs in other essential services it already provided to them. However, in this case we considered that EWS had both the ability and incentive to raise prices and lower service quality. We were unable to take a view on whether it had had the same incentives and abilities in other, unspecified markets at other times. We also noted EWS's comments about needing to retain Marcroft as an independent business. However, it would still be controlled by EWS and it would be economically rational for EWS to ensure that Marcroft operated in the best interests of EWS as a whole. In this respect we noted that three senior EWS employees had been appointed Directors of Marcroft upon completion of the merger.

7.113 EWS also argued that there were no wagons at risk. We thought that small customers were likely to have some choice of provider. However, for customers who required national coverage from a wagon maintainer, we concluded that there were only two suitable maintenance providers, and that two of EWS's competitors considered that only Marcroft offered a suitable service (see paragraph 7.58). Marcroft currently maintains over 3,800 wagons, including wagons operated by all of EWS's main rivals in the haulage market. This, combined with our analyses of market entry and countervailing buyer power (see paragraphs 7.171, 7.172, and 7.179), which showed the market was an unattractive one to enter with some significant barriers to entry, and limited scope to exercise countervailing buyer power, led us to believe that there were wagons at risk from the merger. It was clear to us that at least EWS's rivals in the haulage market could be faced with lower service quality or higher prices (and possibly many other of Marcroft's customers). We did not believe that there was only a concern if there was nowhere else that a company could get its wagons maintained. We considered that there could be problems if the only alternatives may be expected to result in lower service quality or higher prices and that these may be expected to occur as a result of the merger.

- *The effect of the prohibitions of abuse of dominance*

7.114 EWS told us that in assessing whether the merged entity would have an incentive to foreclose its rivals we should take account of the fact that such conduct would be likely to constitute a breach of the prohibition of the abuse of a dominant position contained in Article 82 of the EC Treaty and/or the Chapter II prohibition of the Competition Act 1998 and that any attempt to engage in such conduct could be restrained under those provisions.⁷⁹

7.115 We noted that conduct found by the competition authorities to have infringed the prohibition can be the subject of interim and final directions to bring the conduct to an end and can lead to significant financial penalties.

⁷⁹EWS main submission to the CC, paragraph 8.34. Section 18 of the Competition Act 1998 provides, 'any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom'. Article 82 makes equivalent provision where the conduct has an effect on trade between Member States. EWS refers to the approach adopted by the Court of First Instance in Case T-210/01 *General Electric v Commission*. We have also noted the points made by the European Courts in Case T-5/02 *Tetra Laval BV v Commission* [2002] ECR II-4381 and Case C-12/03 P *Commission v Tetra Laval BV*.

- 7.116 We therefore considered whether in the circumstances of this case the prohibition would act as a disincentive to the conduct on the part of the merged entity that is otherwise in our view to be expected.
- 7.117 We considered that the deterrent effect principally depended on three factors: first the likelihood that the conduct expected would contravene the prohibition and be illegal, secondly the likelihood of any such conduct being the subject of successful enforcement action, and thirdly the time frame within which such enforcement action could be taken.
- 7.118 We considered that if the merged entity enjoyed a dominant position on the wagon maintenance market then lowering service levels and raising prices for maintenance could both in principle constitute an abuse of that position.
- 7.119 However, as to the raising of prices for maintenance to competitors in the freight haulage market, we noted that the level at which a price becomes so excessive as to constitute an abuse of a dominant position is far from clear. This is reflected in the fact that there have been few decisions by either the OFT (and sectoral regulators) or the European Commission finding abuse on the basis of excessive prices. Given the uncertainty surrounding the application of the prohibition to allegations of excessive pricing, we did not consider that the prohibition on abuse of dominance would provide much of a disincentive to the merged entity to raise prices (in addition to the uncertainties of the enforcement process outlined below).
- 7.120 As regards the lowering of service levels, a number of factors appeared to us to be potentially relevant. These included how quickly an alleged breach of the prohibition was brought to the attention of the competition authorities, their resources and priorities at the time any complaint was made, their ability to uncover the evidence necessary to establish any infringement and the cost and time it would take to complete the necessary administrative procedure and to issue a decision. These factors are relevant both to the prospect of any enforcement action by the competition authorities and also to its likely time scale.
- 7.121 In our view the merged entity would not have to delay maintenance work for long before serious damage was caused to the ability of third parties to fulfil and retain their contracts in the freight haulage market.
- 7.122 In this regard we consider that there is a significant risk that such conduct would not be readily ascertainable before the harm we expect had occurred. It appeared to us that such allegations would be likely to require significant investigation to determine the true reasons for delays that might have arisen from a particular piece of maintenance work.
- 7.123 Also we noted that EWS is already involved in a long-running investigation by ORR in the coal haulage market. This started in 2001 but has not yet been concluded (see Appendix D paragraph 5). In addition, we noted that another investigation into complaints against EWS was terminated by ORR on the grounds of resources in the light of a change in conduct by EWS which removed ORR's concerns (see Appendix D paragraph 3). We do not make any inference as to whether these or any other complaints against EWS were or are well-founded but they are illustrative of the practical considerations that may arise in the enforcement process and the time scale involved. In identifying the potential length of investigations, we wish to make clear that we are not making any criticism of the conduct and effectiveness of the enforcement process itself.

- 7.124 EWS told us that the length of the enforcement process, and its associated enormous cost in legal expenses and lost management time, imposed a disincentive to risk any behaviour that could be regarded as infringing competition law. In our view however, the uncertainty of whether the prohibition actually applied to prices set at a particular level and the practical realities of the enforcement process outlined above are likely to diminish the deterrent effect of the prohibitions. In addition these practical realities cast doubt on whether any attempt by the merged entity actually to engage in the conduct identified could necessarily be addressed immediately.
- 7.125 We recognize that where applicable the prohibitions and the potential for investigation are factors that will have some potential deterrent effect on the merged entity. However, for the reasons given above, we have in this case found that effect uncertain and difficult to evaluate.
- 7.126 Against these uncertainties we balanced the clear economic incentives set out above (in paragraphs 7.94 to 7.105). Overall we concluded that the deterrent effect of the prohibitions on abuse of dominance was too uncertain to counteract the incentives that led us to conclude that the merger may be expected to lead to an SLC.

Conclusions on the effects of the merger in the haulage market

- 7.127 We conclude that the merged entity would have both the incentive and the ability to lower the quality of service to rivals, and raise rivals' costs, in the haulage market. We believed that the incentive to lower service quality was stronger than the incentive to raise prices. We concluded that EWS may therefore be expected to follow this course of action. We conclude that this may be expected to give rise to an SLC.
- 7.128 We considered what the adverse effects of the merger would be. We believed that EWS could be expected to lower service quality to competitors in the haulage market. This could lead to increased downtime for some wagons, and might lead to EWS's competitors struggling to fulfil all of their commitments. Again, this might lead to their losing profitability, and ultimately, losing contracts. This in turn would result in higher prices or lower quality service for end-users.
- 7.129 We also believed that EWS could be expected to raise prices to competitors in the haulage market. This would result in EWS's competitors either facing reduced profitability or having to pass on these additional costs to haulage customers. In the latter case, we considered that some customers of haulage companies might consider switching to a lower cost provider, if they were able to, if the price rise was significant. In either scenario EWS's competitors would be less competitive as a result of EWS's actions, and haulage customers would be faced with prices higher than they would have been without the merger.
- 7.130 As noted in paragraph 5.41, we did not reach a firm conclusion on whether there was one rail haulage market or whether there were several smaller ones, covering sectors such as coal haulage and intermodal haulage. So we considered whether the downstream market definition would affect our finding of an SLC.
- 7.131 As shown in Table 3, EWS was the leading player in rail haulage ([X]). We were content that the adverse effects we identified would be present in any downstream market where EWS was the leading supplier of haulage services. The only area we were aware of where it did not have the highest market share was intermodal haulage, where Freightliner was the market leader. In this case we believed that EWS's incentive to raise prices was reduced, but it still had the ability and incentive to lower service quality. By lowering service quality it could quickly inflict damage on

its competitors, raising their costs and reducing their competitiveness. We were content, therefore, that some or all of the adverse effects identified would be present whether the downstream market was defined as freight haulage or as smaller haulage markets.

7.132 Moreover, for customers who needed national coverage there was limited choice (see paragraph 7.58). For such customers Wabtec would offer the only realistic alternative. We did not believe Wabtec could be expected to offer a similar service to that provided by Marcroft at a similar price to that offered by Marcroft prior to the merger. Moreover, if, after the merger, Marcroft did raise prices because of its unilateral incentive to do so, created by vertical integration, this would lessen the competitive constraint on Wabtec, allowing that company unilaterally to raise prices or reduce service quality because it is the only realistic alternative to Marcroft for these customers. It would therefore be able to increase the detriment to customers of the merger. Any customers switching to Wabtec would be lost to Marcroft, but to the extent that they suffer a price increase or service quality degradation as a result of that switching, the merged entity would benefit through the 'raising rivals' costs' mechanism described in paragraphs 7.96 and 7.97.

7.133 It should be noted that EWS's ability to act in this way is not dependent on Marcroft's position in the wagon maintenance market being enhanced by taking on the maintenance of EWS wagons. As a result of the merger Marcroft would still have the ability and (as a result of the merger) will acquire the incentive to lower service quality or raise prices.

Market entry/expansion

7.134 Having concluded that the merger may be expected to give rise to an SLC, we turned to whether there were features of the market which would prevent or alleviate the SLC or any adverse effects which have arisen or may be expected to arise. We first considered whether the wagon maintenance market was an attractive one to enter or to expand within, and whether there were significant barriers to entry or expansion. This was relevant to whether new entry or expansion, or the threat of it, would constrain the merged entity from raising rivals' costs or lowering service quality to them.

The attractiveness of entry into the market

7.135 We considered whether potential entrants would find the wagon maintenance market an attractive one to seek to enter. We considered that the most likely potential entrants were those who were already active in a related field, as they were most likely to have relevant skills or infrastructure already in place. This included passenger carriage maintenance suppliers and general rail infrastructure companies.

7.136 As set out in paragraph 4.2, the haulage market has been showing some signs of growth over the last five years. However, we concluded in paragraph 4.7 that whilst we expected there to be modest growth in haulage, the growth in wagon maintenance would be less than the growth in haulage over the short to medium term. As noted in paragraph 4.5, EWS believed that even the modest rail freight growth forecasts made by the Rail Freight Users Group were overstated [§]. As noted in paragraph 4.8, the wagon maintenance market is worth around £[§] a year (not taking into account in-house maintenance). It is not, therefore, a large market.

7.137 We were told by several parties that the market had low margins, much lower than those in the substantially larger passenger carriage maintenance market (see

paragraph 7.8). We noted that Wabtec had diversified into passenger carriage maintenance (see paragraph 7.52), and, before the merger, Marcroft had also been seeking to break into the passenger carriage maintenance market. EWS told us that margins would need to increase substantially before entry into the wagon maintenance market became attractive. The passenger carriage maintenance providers who responded to us told us that they had no interest in entering, or expanding within, the wagon maintenance industry, though one haulage company told us that a passenger carriage maintenance provider (Pullman Design and Fabrication Limited) had agreed to bid to carry out GR maintenance on a small number of wagons.

7.138 Allied to the low margins in wagon maintenance, as noted in paragraph 5.26, are the rates charged by wagon maintenance providers which are, on the whole, significantly lower than those charged in the passenger carriage maintenance market. EWS told us that this reflected the lower skill levels needed for staff working on wagons compared with passenger carriages. This means that passenger carriage maintenance operators would have to either employ lower skilled staff in order to enter the market, or use more highly skilled staff. In the latter case they would either have to charge correspondingly higher rates or operate the contracts at a loss. In either case, it appeared unlikely to be an attractive proposition, and it did not suggest that passenger carriage maintainers offered a competitive constraint as potential or actual entrants.

7.139 Evidence from EWS appeared to corroborate this. EWS told us that the one passenger carriage maintenance provider also active in maintenance in the field for wagons (Bombardier) had a similar cost base to itself, and that it provided the same level of competitive constraint in this market as EWS for this reason (though, as noted in paragraph 5.27, Bombardier told us that its overheads, and hence its cost base, would be higher than that of conventional operators or maintainers). As noted in paragraph 7.69, we concluded that EWS was not a competitive constraint in the wagon maintenance market.

7.140 We concluded that the wagon maintenance market was not an attractive market for companies in related markets to enter. We thought that companies not currently in a rail-related industry would be even less likely to find the market an attractive one. The lack of significant new entry in recent times appears to support this.

Barriers to entry or expansion

7.141 Having concluded that the market was not an attractive one to enter, we looked at whether potential entrants could enter the market, or smaller players could expand within the market, should they nevertheless choose to, or if conditions improved (for example if margins started increasing).

7.142 The wagon maintenance market is a mature market, and, as set out in paragraph 4.2, has suffered from the significant reduction in the number of wagons over the last 40 years. Against this background, prior to the merger, there were only two major suppliers of third-party wagon maintenance services; the other maintenance providers in the market were very small and had market shares below 5 per cent (see Table 6). This raised the possibility that there was a significant barrier to expansion even if entry on a small scale was feasible. In this context, we noted that a small provider of wagon maintenance services would need additional finance in order to fund significant expansion in the market. It was not clear to us that it would be easy to find financial providers willing to fund companies seeking to treble or quadruple their size by organic growth within a small industry with low margins, limited growth possibilities, and a low tangible asset base. We considered that the concerns of

potential providers of finance would be heightened by the degree of concentration already in the market before the merger—we concluded in paragraph 7.51 that only Marcroft and Wabtec were able to offer national coverage for customers.

- 7.143 Barriers to entry are features that may prevent or restrict firms from exploiting profitable opportunities in a market and hence might enable a merged firm to raise price above costs persistently without significant loss of market share to other firms.⁸⁰ The extent of barriers to entry needs to be assessed with regard to the size of the market and the possible gains from entry. As noted in paragraph 4.8 the third party wagon maintenance market has been estimated to be worth around £[~~3~~] million a year. EWS submitted that the rail freight maintenance market is a shrinking industry, though as noted in paragraph 4.6 the haulage market has grown in the last five years and we judge it is likely to continue to grow to a modest extent. Therefore, when assessing the extent of barriers to entry, it is important to bear in mind the limited revenue that could be gained by a new entrant to this market.
- 7.144 We concluded in paragraph 5.44, that the relevant market for this inquiry was the wagon maintenance market in Great Britain, which includes light in-field maintenance, GR maintenance, CBM and SDG maintenance. Despite the single relevant maintenance market, it is possible for new companies to enter the market by offering only one of these four different types of maintenance. We recognized, therefore, that the barriers to entry may vary according to the type of wagon maintenance to be offered by the new entrant.
- 7.145 EWS told us that there were no significant barriers to entry. We considered all the potential barriers relating to light in-field maintenance, GR, CBM and SDG in Appendix F. The key potential barriers are considered below.

Barriers to entry and expansion: Light in-field, CBM and SDG maintenance

- 7.146 Light in-field, CBM and SDG maintenance of wagons take place at a location agreed by the customer and the maintenance provider, such as the customer's premises or a railway siding or terminal. The various barriers to entry and expansion into the provision of these maintenance services are discussed in paragraphs 2 to 9 and 15 to 16 of Appendix F.
- 7.147 The ease of entry into the market on a small scale and on a large scale are likely to be different. The movement of wagons has a bearing on the number of companies able to provide maintenance services in the field. As noted in paragraph 7.40, for wagons making the same regular point-to-point journeys, a wagon maintainer offering the appropriate regional coverage will probably suffice. Thus, small-scale entry could be achieved without the need for a maintenance provider having access to other outstations where maintenance could be carried out.
- 7.148 However, as also noted in paragraph 7.40, for wagons that are used on a number of different routes (rather than travelling on a single point-to-point route), and those travelling point-to-point over large distances, there appeared to be a strong customer requirement for access to a national network of outstations with maintenance teams to work at those outstations. We first considered, therefore, the need for national coverage and whether this constituted a barrier to entry, or expansion, on a large scale.

⁸⁰Merger References: Competition Commission Guidelines (CC2), June 2003, paragraph 3.49.

- 7.149 We concluded in paragraph 7.48 that EWS's competitors in the haulage market did require national coverage from a wagon maintainer.
- 7.150 We therefore considered what was needed to achieve national coverage. We believed that there are two main requirements: access to sidings at sufficient locations around Great Britain; and access to mobile staff with vehicles that could carry out maintenance at unmanned stations. We consider each of these in turn.
- 7.151 Two maintenance providers told us that access to outstations or sidings was the most significant barrier to entry and expansion.⁸¹ Access to sidings or outstations is essential for providing maintenance services in the field. EWS told us that most maintenance takes place on customers' sites, and that the majority of the rest takes place on outstations to which customers have historical access rights. It told us that access to maintenance sites moved with a contract, so if a customer changed maintenance provider the new maintenance provider would automatically gain access to the outstations. Further, EWS told us that access did not constitute a barrier to entry as customers could always seek access on behalf of the maintenance provider in order to service the customer's contract and it was not aware of a new or smaller entrant losing a contract because it could not get access to a site. It told us that while a few third parties might feel such a barrier existed, it was not a realistic barrier in practice and had not restricted any competitor in the market from carrying out operations as a wagon maintenance provider. Network Rail told us that there were no large barriers to wagon maintainers wishing to go on site to carry out maintenance, and several others put to us that most maintenance was carried out on customers' sites.
- 7.152 We thought that very small entrants might be able to avoid the need for their own dedicated sidings/outstations by focusing on contracts for customers with outstations on their own property; however, as noted in paragraph 7.147, entry on a scale sufficient to provide a competitive constraint to the merged entity, or expansion to such a scale, would probably not be possible without gaining access to sites in order to provide maintenance at various locations for contracts for customers with a broad geographic scope. Such customers would include both those whose wagons do not follow point-to-point routes, such as haulage companies, and those whose wagons do follow point-to-point routes which span large areas of the country.
- 7.153 We were told that customers could seek access to outstations; however, haulage is not a heavily regulated activity. It will not be clear for some time whether the effect of the 2005 Regulations referred to in paragraphs 4.35 and 4.36 will be to ensure that companies cannot charge excessive access fees or refuse to grant access to an outstation to a wagon maintainer.
- 7.154 We found that there was conflicting evidence as to whether access to sidings constituted a barrier to entry. It was clear that some companies did not consider it an issue. However, some others clearly did consider it to be a key barrier, and there was a clear perception on the part of at least some of Marcroft's competitors that this was a barrier to achieving entry into, or expansion within, the wagon maintenance market. We did not reach a firm conclusion as to whether access to sidings constituted a significant barrier to entry or expansion, though we did conclude that the perception among some companies that it was a barrier was genuine and in itself would discourage entry to some extent.

⁸¹ *Summary of a hearing with Arlington Fleet Services*, paragraph 5; *Summary of a hearing with Direct Rail Services*, paragraph 5. We were also told by Freightliner that obtaining access to suitable rail-connected facilities was a substantial barrier to entry: *Submission from Freightliner*, 26 April, paragraph 3.3.

- 7.155 We then considered whether access to labour and vans equipped to carry out servicing at unmanned outstations was a barrier. EWS told us that the servicing of wagons did not require high skill levels and that appropriate labour could easily be found through advertising. On the other hand we did receive evidence that it had not proven easy to train up staff who had not previously worked on the railways to carry out wagon maintenance.⁸² However, we did not think that access to appropriately-qualified staff was a significant barrier.
- 7.156 We did consider that, whilst finding appropriately-qualified staff was not a significant barrier, having enough work for them to do could be. We believed that there were economies of scale in running an outstation business. It would be difficult to offer national coverage for a small number of customers with a small number of wagons, as maintenance staff, spread across Great Britain, would not be fully utilized. Only by having a significant number of wagons to service could a maintenance service offering national coverage make full use of its staff and be cost-effective.
- 7.157 On balance, therefore, we thought that it was clear that some customers wanted, and did need, national coverage in order to maintain their wagons. We thought that if a company wished to enter the market on a large scale it would need access to sufficient outstations to service wagons, and that there was a genuinely-held perception among some companies that access to outstations was a key barrier. We were unable to conclude definitively on whether this was the case, though we did consider that this perception did in itself create some disincentive to try and achieve national coverage in wagon maintenance.
- 7.158 Whereas none of the individual barriers associated with achieving entry on, or expanding to achieve, a national scale appear insurmountable, taken together we concluded that achieving national coverage is a significant barrier to entry.
- 7.159 We next considered whether the level of investment needed to start providing maintenance services in the field could be a barrier to entry. EWS estimated that the cost of setting up a light in-field wagon maintainer for an *established engineering company* to achieve a 5 per cent market share is £84,300.⁸³ However, we considered that this was likely to be the lower bound of costs that a *new entrant* faces, since (a) the estimate did not include any costs for back office administrative support, management and so on, in which a new entrant would need to invest, and (b) the estimate also omitted some important costs associated with entry, such as insurance, which a variety of parties told us could be considerable.⁸⁴ A third party also argued that EWS's estimate was too low.⁸⁵ We also noted that only Marcroft and Wabtec among third party maintenance providers have a greater than 5 per cent market share. This suggested to us that gaining a 5 per cent market share in this market was not a trivial task, and unlikely to be easy for a new entrant.
- 7.160 Therefore, we consider that capital requirements and the need for insurance could act as a significant barrier to entry, and could also act to a lesser extent as a barrier to expansion (particularly in cases where the value of insurance coverage needed to be extended).
- 7.161 We considered the other significant barrier to the provision of maintenance services in the field was about reputation—the risk to customers of switching maintenance provider, especially to a new provider. If the quality of maintenance provided by a

⁸²See, for example, *Summary of a hearing with EG Steele and Co Limited*, paragraph 14.

⁸³EWS main submission to the CC, paragraph 7.27 (b).

⁸⁴See, for example: *Summary of a hearing with EG Steele and Co Limited*, paragraph 9; *Summary of a hearing with Arlington Fleet Services*, paragraph 4; *Summary of staff hearing with WH Davis*, paragraph 11.

⁸⁵See *Submission from Freightliner, 26 April*, paragraph 3.5.

supplier is substandard, then customers may suffer significant damage, including having wagons out of service, having trains running late, and potentially losing haulage contracts. In the worst case scenario, there are potential safety issues involved. Operators may be reluctant to switch to a new entrant supplier, since such an entrant will not have a track record of providing high quality maintenance services, and the perceived risks may therefore act as a barrier to entry to the market. To a lesser extent, these risks may also hamper expansion by small companies, as they will have less of a track record than their larger rivals, especially in fulfilling large-scale maintenance contracts (though they will have a track record within the industry).

- 7.162 We noted in paragraph 7.12 that EWS only provided us with nine examples of customers switching maintenance providers over the last five years. We also considered how the new entrants that had been brought to our attention had entered the market. Channel Commercials' entry into the market was sponsored by Steele, who had been, and was still, training Channel Commercials' staff on the job over a period of several months in order to ensure that a sufficient quality of service was provided. Clarke Chapman told us that it had entered the market by winning a contract to maintain wagons it was already building. Arlington told us that, whilst it was doing ad-hoc 'running repair' work, it had not yet won a routine maintenance contract, despite having been active in the industry for three years.
- 7.163 The evidence led us to conclude that the risk associated with switching, especially to a new maintenance provider, constituted a significant barrier to entry or large-scale expansion.

Barriers to entry and expansion: GR

- 7.164 Our analysis of the various barriers to entry and expansion for providing GR maintenance is set out in paragraphs 10 to 14 of Appendix F. We considered that there was one significant barrier to entry into GR maintenance in addition to the barriers relevant for maintenance provided in the field, the availability and cost of rail-connected workshops.
- 7.165 In order for a company to start providing GR maintenance services (as opposed to subcontracting for these services), a workshop is required. For a company maintaining a small number of wagons (perhaps as part of a wider portfolio of engineering services) it is possible that the workshop would not need to be rail connected, as in some cases it is cheaper to move individual wagons to a workshop by road than by rail. However, for the delivery of larger numbers of wagons it is significantly more cost-effective to move wagons by rail, so a rail connection would probably be needed. The construction of such a workshop from scratch would be very expensive, requiring an investment of several million pounds (according to EWS). Instituting rail links to connect a new workshop to the national rail network could potentially take years.⁸⁶ The substantial capital investment requirement and long lead-times required to construct a new workshop impose a high barrier to entry on potential entrants to the supply of GR maintenance services. Entry on a small scale would not be possible; entry to the supply of GR services is likely to require a significant guaranteed revenue stream to justify the investment. The GR market can also be quite volatile; we were told that one third party expected to have [X] wagons given GR maintenance in 2006, but around [X] of its wagons would need a GR maintenance event in 2007. This would further reduce the attractiveness of entry.

⁸⁶It should be noted that the costs of reopening a mothballed site may also be substantial, and in our view does not present an alternative of sufficient viability to overcome this barrier to entry.

Conclusion on barriers to entry and expansion

7.166 For the reasons set out in paragraphs 7.146 to 7.165, we conclude that there are barriers to entry into, or expansion within, the wagon maintenance market, some of which would appear to be significant, particularly given the comparatively small size of the market and the limited revenues that could potentially be gained by a new entrant.

Likelihood of entry or expansion

7.167 Despite the high barriers to entry discussed above, we considered whether these barriers could be overcome, either through a large customer sponsoring entry, or through an existing maintainer of passenger carriages diversifying into the maintenance of wagons. A discussion of these issues is contained in Appendix G. We believe that these possible strategies are unlikely to lead to significant entry to the British wagon maintenance market in the short term.

7.168 We also considered whether in-house maintenance providers would expand their operations to offer third-party maintenance services. As noted in paragraph 5.16, EWS told us that they thought this was a likely scenario for all in-house maintenance providers other than EWS itself (because of its high cost base), particularly in the case of DRS and Freightliner, which have their own in-house maintenance facilities.

7.169 In this respect, EWS noted that Freightliner had recently acquired a depot from LNWR (the Midland Road site) and had been in the market trying to recruit maintenance staff. However, Freightliner told us that it intended to use the site for locomotive maintenance. It intended to expand the use of the Midland Road site to provide locomotive maintenance services to its entire Heavy Haul fleet as opposed to its existing use of simply providing maintenance to the eastern-located fleet. Accordingly, the throughput of the site would substantially expand [redacted] and the potential ability to provide alternative maintenance would diminish. It told us that it was also considering using the site to maintain locomotives for the Freightliner intermodal fleet. If it did do this, the existing capacity of the site for its primary purpose of maintaining [redacted].

7.170 We concluded, as noted in paragraphs 5.17 and 5.18, that neither DRS nor Freightliner could easily enter the third-party maintenance market.

Conclusion on entry/expansion

7.171 We conclude, therefore, that entry into the wagon maintenance market is unattractive, and that there would need to be significant changes to render it more attractive, such as a significant increase in margins for maintenance providers. Further, even if a company sought to enter the market, there are some significant barriers to entry which would render such entry difficult.

7.172 Given the low margins and small size of the market, we conclude that entry into the market of a scale sufficient to offset any potential SLC arising from the merger is unlikely. The lack of scale entry over a long time period, and the lack of players in the market with a significant market share, appears to support our conclusion.

Countervailing buyer power

7.173 Having concluded that market entry, or the threat of it, was not sufficient to prevent or alleviate an SLC, we considered whether customers had the ability to exert buyer

power in order to keep prices low or ensure service quality levels remained acceptable. EWS told us that many buyers of maintenance services were large, often multinational, companies with significant resources, who can and do exercise considerable buyer power in negotiations with wagon maintenance providers.⁸⁷ It told us that Marcroft suffered real terms price decreases in respect of most of its customers over the three years from 2003 to 2005, though as we noted in paragraph 7.59 we concluded that Marcroft had had a degree of market power before the merger.

- 7.174 We considered whether EWS's competitors, if faced with higher prices or lower service quality from their wagon maintenance provider, could change suppliers. However, we concluded that only two wagon maintenance providers could offer the national maintenance coverage required, and that two of EWS's competitors in the haulage market considered that only one company, Marcroft, could provide wagon maintenance services to the level of satisfaction they required (see paragraph 7.58).
- 7.175 We considered whether any of the current small maintenance providers would be able to take on all the light in-field maintenance for Freightliner's Heavy Haul fleet. As noted in paragraph 4.26, Freightliner has approximately [X] Heavy Haul wagons currently serviced by Marcroft. As noted in paragraph 4.16, Davis, the third largest third party maintenance provider, currently provides light in-field maintenance services for 330 wagons, though it has no signed contracts. [X] It is not clear that all Marcroft staff working on Freightliner wagons work exclusively on these contracts. As a result a new provider may be expected to find itself having to recruit possibly significant numbers of staff at short notice in order to service such a contract. We also noted that in order to expand so rapidly, a small maintenance provider would require financing. It was not clear to us that any small maintenance provider would find it easy to obtain the funding necessary to expand its operation organically so rapidly in such a short time. Nor did we think it would be easy for any of these companies to manage such a rapid expansion while maintaining the required standards of service.
- 7.176 We concluded, therefore, that there would be significant risks for EWS's competitors switching their maintenance needs to any of the small maintenance providers, because of the uncertainty whether any of them could successfully expand rapidly enough to take on the whole of a contract. This would constrain their ability to exercise any degree of buyer power they might otherwise have.
- 7.177 We also considered whether a haulage provider could split its maintenance needs between more than one provider, possibly on a geographic basis. We saw no particular barrier to separating out any GR work into a separate tender (some companies already do this). However, splitting light in-field or SDG maintenance could only be easily achieved if wagons were predictably following certain routes and maintenance providers could be assigned particular flows. This would be possible, though administratively more expensive for the haulier. However, for companies whose wagons move around less predictably this would be more difficult, and smaller maintenance companies would need to work together in a way they had failed to do in the past.
- 7.178 Finally we considered whether haulage providers could supply their own maintenance needs. EWS told us that this was easily achievable and would not take long. However, we concluded in paragraph 7.56 that haulage providers could not do this quickly, easily and economically.

⁸⁷EWS main submission to the CC, paragraph 7.12.

7.179 We concluded that the scope to exercise countervailing buyer power in this market was, therefore, limited, and that this would not act to prevent or mitigate an SLC in the market.

Conclusions on the SLC test

7.180 We conclude that the completed acquisition by EWS of Marcroft is a relevant merger situation under section 23 of the Act and that we therefore have jurisdiction to consider the competitive consequences of the merger.

7.181 For the reasons set out in paragraphs 7.127 to 7.129, we conclude that the merger has resulted, or may be expected to result, in an SLC in the market for haulage services in Great Britain. This may be expected to result in the adverse effects of lower service quality and higher prices for haulage operators and customers of haulage operators than would have been the case had the merger not taken place.

8. Remedies

8.1 Having determined that a relevant merger situation has been created that has resulted or may be expected to result in an SLC in accordance with section 35(1) of the Act we now turn to remedies.

8.2 Section 35(3) of the Act requires us to consider three further questions:

(a) whether action should be taken by the CC for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effects which have resulted, or may be expected to result, from the SLC;

(b) whether the CC should recommend the taking of action by others (eg regulators, government departments) for the purpose of remedying, mitigating or preventing the SLC concerned or any adverse effects which have resulted, or may be expected to result, from the SLC; and

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

8.3 In deciding the questions above the CC shall, in particular, have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the SLC and any adverse effects resulting from it.⁸⁸ The *CC Merger Guidelines* provide that the CC's starting point will be to choose the remedial action that will restore the competition that has been, or is expected to be, lessened as a result of the merger. Given that the effect of the merger is to change the structure of the market, remedies that aim to restore all or part of the status quo ante market structure are likely to be a direct way of addressing the adverse effects.⁸⁹

8.4 In choosing appropriate remedies, the CC will consider the effectiveness (including feasibility of implementation) of different remedies and their associated costs and will have regard to the principle of proportionality.⁹⁰

⁸⁸Section 35(4).

⁸⁹*Merger References: Competition Commission Guidelines (CC2)*, June 2003, paragraph 4.23.

⁹⁰*Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8)*, December 2004, paragraph 1.7.

8.5 In deciding the questions above the CC shall also have regard to the effect of any remedial action on any relevant customer benefits arising from the merger.⁹¹

Remedy options

8.6 In our Notice of Possible Remedies published on 23 May 2006, we suggested that the divestiture of the outstation business of Marcroft was the remedy which appeared most appropriate, but that we were willing to consider any practical alternative remedies put to us. We received comments on this Notice from EWS, Marcroft and several third parties and we considered these comments when reaching our decision on remedies.

8.7 In response to the Notice, EWS commented on the structural remedy suggested and also suggested that it might be possible to develop a series of behavioural remedies which would remedy the SLC identified. EWS also developed proposals for the divestiture of a part of the Marcroft outstation business.

8.8 There are three remedy options which we consider:

- behavioural remedies;
- divestiture of the Marcroft outstation business without the Stoke workshop; and
- divestiture of part of the Marcroft outstation business only.

8.9 We consider the behavioural remedies and the divestiture remedies options in turn. We then consider customer benefits arising from the merger.

8.10 In this case the only remedy options appear to be actions for the CC rather than for other bodies.

Behavioural remedies

8.11 We considered whether behavioural remedies were more suitable than divestiture remedies. Our Notice of Possible Remedies noted that we considered that behavioural remedies were unlikely to be effective in addressing the SLC and its resulting adverse effects.

8.12 We note that as set out in the CC's guidelines,⁹² structural remedies were likely to be preferable to behavioural remedies, as they address the effects of a merger directly and require comparatively little, if any, monitoring or enforcement of compliance. Further the conditions listed in the CC's guidelines as being appropriate for behavioural remedies⁹³ do not appear to apply in this case. The SLC is not expected to be of limited duration and the relevant customer benefits expected from the merger are not substantial (see paragraphs 8.64 to 8.66). Moreover, in this market, prices are individually negotiated, products have limited homogeneity,⁹⁴ service and quality may vary widely and contractual relationships are relatively informal (see paragraph

⁹¹Section 35(5) of the Act, see also *Merger References: Competition Commission Guidelines (CC2)*, Section 4.

⁹²*Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8)*, December 2004, paragraph 1.8.

⁹³*Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8)*, December 2004, paragraph 1.8.

⁹⁴Marcroft told us that such services can include technical reports, material stock holding and the supply of components as well as performance history on wagon fleets.

7.9). These conditions create significant obstacles to the successful introduction, monitoring and enforcement of behavioural remedies as outlined below.

- 8.13 EWS told us that it believed it might be possible to construct a behavioural remedy comprising, for example, undertakings to continue to supply Marcroft customers on an open and non-discriminatory basis and to offer compensation for not meeting service standards (one customer also suggested that this could work with strict penalties for non compliance, while another considered that a behavioural remedy provided the optimal solution in this case), in each case possibly backed up by a rapid, binding arbitration process. However, EWS also told us that it shared some of our concerns about the likely effectiveness of behavioural remedies in this market.
- 8.14 EWS also suggested that it would be possible to consider a remedy based upon the appointment of independent non-executive members to the Marcroft board (or a supervisory board structure, though in EWS's view this would be less desirable) in order to ensure non-discrimination and 'fair play' in Marcroft's dealings with all of its customers. EWS told us that it has experience of operating a supervisory board structure for these purposes for its Railways Approvals Limited subsidiary, which carries out railway certification services for some of EWS's competitors. The certification process enables new locomotives and wagons to be approved for operation on Network Rail's infrastructure. One customer thought a supervisory board structure may be effective.
- 8.15 We considered EWS's suggestions carefully. We did not consider that behavioural remedies along the lines of those suggested by EWS would be effective and practical in this case for the following reasons:
- it has been put to us that significant damage could be inflicted over a very short timescale,⁹⁵ which monitoring and subsequent enforcement of compliance would only remedy when it was too late;
 - a behavioural remedy aimed at preventing preferential treatment of EWS would be extremely difficult to monitor because it would be difficult to distinguish between necessary commercial prioritization and decisions taken to disadvantage a competitor;
 - the supervisory board structure would not adequately address our concerns, because of the short timescales involved, and because action (or inaction) which could harm competitors could be viewed as essentially operational in nature and would be unlikely to come to the attention of the supervisory board in advance, and would only come to the supervisory board's attention as a result of a customer complaint when the damage had already been done. EWS suggested that such a board could take an active role in monitoring ongoing operational matters (for example on a sample basis), but in our view this would not provide a robust way of ensuring no adverse effects arose. Thus a similar supervisory board structure to that operated by EWS for Railway Approvals Limited is unlikely to address the issues raised in this case; and
 - given the variation in pricing, lack of homogeneity in product and service levels and the informal contractual relationships noted in paragraph 8.12, and the difficulty of specifying and observing the outputs to be controlled, monitoring and enforcement of any remedies would be exceptionally difficult.

⁹⁵See *Summary of a hearing with Direct Rail Services*, paragraph 15, and paragraph 7.82.

8.16 Having considered the behavioural remedies put forward by EWS, we conclude that they would not satisfactorily remedy the SLC and the adverse effects identified, and would not, therefore, be an effective remedy. Similarly we did not consider that any other behavioural remedy would satisfactorily remedy the SLC and the adverse effects identified.

Divestiture remedies

8.17 We then turned to consider divestiture remedies. Marcroft essentially consists of two businesses, the Stoke workshop and the outstation business. We found an SLC in the market for haulage services (see paragraph 7.181). We considered whether divestiture of the Marcroft outstation business only, allowing EWS to retain the Stoke workshop, would remedy the SLC and the adverse effects identified. This included assessing whether a separate outstation business would be viable without the Stoke workshop. We then further considered whether divestiture of only part of the outstation business would remedy the SLC and adverse effects.

8.18 The CC's guidance⁹⁶ states that '[to] be effective, a divestiture should involve the sale of an appropriate divestiture package to a suitable purchaser through an effective divestiture process'.

8.19 The guidance also identifies the three broad categories of risks that may possibly impair the effectiveness of divestiture remedies as follows.⁹⁷

- Composition risks—these are risks that the scope of the divestiture package may be too constrained or not appropriately configured to attract a suitable purchaser or may not allow a purchaser to operate effectively and viably in the market.
- Purchaser risks—these are risks that a suitable purchaser is not available or that the merger parties will dispose to a weak or otherwise inappropriate purchaser.
- Asset risks—these are risks that the competitive capability of a divestiture package will deteriorate prior to completion of divestiture, for example through loss of customers or key members of staff.

8.20 These risks are assessed to evaluate whether it is a viable option to divest the Marcroft outstation business without the Stoke workshop, and whether, if so, it is a viable option to divest a proportion of the Marcroft outstations only, leaving the remainder with EWS.

Divestiture of the Marcroft outstation business without the Stoke workshop

8.21 In considering the scope of any divestiture package we noted our guidance which provides that:

[p]artial prohibition and divestment (rather than outright prohibition or full divestment) may be the most appropriate remedy for example, where the competition concern arises in only some of the merged firm's activities or where the merged firm carries out activities in a market or markets other

⁹⁶Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8), December 2004, paragraph 2.2.

⁹⁷Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8), December 2004, paragraph 2.4.

than those in which the merger is expected to bring about an SLC. In these circumstances, outright prohibition or full divestment may be a disproportionate way of remedying the adverse effects of the merger. So long as the area of competition concern and the relevant part of the merged or merging firms can be clearly identified, divestment of assets, or the withdrawal of one of the parties from the market in question, may be an adequate remedy.⁹⁸

8.22 The guidance continues:

Experience shows that there are two key questions that will determine whether partial divestment can be an effective remedy:

- (a) whether the assets to be divested provide the basis of a viable business that can operate independently of the merging firms and, in a reasonably short time, say within one year, can be expected to provide effective and sustained competition to the other firms in the market; and
- (b) whether a purchaser of the assets will be capable of operating the assets and running a viable, competitive business, and have the incentive to compete with the merged firm.⁹⁹

8.23 In line with paragraph 8.19 we considered the risks in separating out the outstation business from the Stoke workshop, by considering the composition risks, purchaser risks, and asset risks. We considered that the major risk was composition risk. We also noted our guidance that states that:

[t]he CC will generally prefer divestiture of an existing business that can compete effectively on a stand-alone basis independently of the merger parties to divestiture of part of an operating unit or a collection of assets. This is because divestiture of such a business is less likely to be subject to purchaser and composition risk.¹⁰⁰

Composition risks

8.24 In considering divestiture of the outstation business alone, a key consideration is whether the outstation business would be a viable stand-alone business. This depends on the buyer being able to operate the outstation business without a central workshop.

8.25 EWS considered that the divestiture package should not include the Stoke workshop as customers' requirements for workshop services could be adequately provided by subcontract arrangements and the workshop was not otherwise necessary to preserve the viability of the Marcroft outstation business.

8.26 Marcroft and another party have suggested that the Marcroft facility at Storrs Hill, near Wakefield, could be used for some limited workshop activity to support the outstation operation. We understand that Storrs Hill is a small workshop facility which is capable of being used to perform many workshop tasks including GR on up to two wagons at a time. Although Storrs Hill may be able to be used to provide some back

⁹⁸Merger References: Competition Commission Guidelines (CC2), paragraph 4.26.

⁹⁹Merger References: Competition Commission Guidelines (CC2), paragraph 4.27.

¹⁰⁰Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8), December 2004, paragraph 3.3.

up capability, and should be included with the divestiture package if required, it is likely that most of the workshop activity would still need to be contracted out.

- 8.27 At least four potential purchasers and customers of the Marcroft outstation business, together with EWS, felt that divestiture of the outstations without the Stoke workshop was a viable option. They also expressed concern about the poor financial position of the Stoke workshop and felt that inclusion of the Stoke workshop in the divestiture package would reduce rather than increase the viability of the divested business.
- 8.28 Several customers raised concerns about separating the outstations from the workshop because they valued Marcroft's 'one-stop shop' of outstation and workshop maintenance. However we believe that their concerns would be addressed if the workshop maintenance was provided on a subcontract as opposed to an in-house basis, provided that the customer was comfortable with the nature of the subcontracting arrangement. Two parties questioned whether the divested outstation business would be able to subcontract with workshop providers because of a perceived lack of workshop capacity. However, EWS and other parties have confirmed that workshop maintenance facilities were readily available and saw no obstacle to these being provided on an appropriate subcontract basis.
- 8.29 As noted in paragraph 2.4 EWS did not have any comparable workshops for wagon maintenance. And as noted in paragraph 6.29 we concluded that, if the merger had not taken place, the Stoke workshop and site would have been sold to someone who would have used them for purposes not related to wagon maintenance. Also, we considered that including the Stoke workshop would increase rather than reduce composition risk, given the substantial underutilization of the workshop and its resulting poor financial performance.
- 8.30 We concluded that in light of the above, rather than divesting the entirety of the Marcroft business, the divestiture package need not include the Stoke workshop. However, to the extent required by a suitable purchaser, the divestiture should include all necessary support services for the outstation business presently conducted from the Stoke location (including administrative support and engineering supervision) as necessary and should preserve access to the Stoke workshop for a limited transitional period (☒) if required by a suitable purchaser to enable alternative arrangements to be set up for subcontracting and storage of materials. This would create effectively a stand-alone business without the encumbrance of the central workshop.

Divestiture of part of the outstation business only

- 8.31 Having concluded that the divestiture package did not need to include the Stoke workshop we then considered whether the divestiture of all or only part of the Marcroft outstation network was necessary, by considering the risk categories discussed in paragraph 8.19.
- 8.32 In considering whether to require divestiture of the whole or only part of the outstation business, EWS said that the VTG contract could be separated from the divestiture because VTG benefits from a pre-existing long-term agreement that will (i) prevent exploitation; and (ii) give it a considerable amount of time to find an alternative supplier or set up a self-supply business. EWS suggested that divestiture of this contract would be disproportionate because third parties would be unaffected by the ownership of Marcroft outstations that do no more than service VTG's fleet and competitors would be unaffected by the exclusion of this business from any divestiture package as the relevant business of VTG would not be contestable [☒]. VTG disputed the assertion that all its work was not contestable. It told us that the

provision of maintenance services for its wagons was contestable in some circumstances, for example if there was a reduction in service quality.

- 8.33 However, we note that the VTG business is a valuable component of the Marcroft outstation business. In total (for outstation plus workshop work) it provides over 40 per cent of Marcroft's revenue. Excluding the VTG contract from the divestiture package is likely to increase composition risk and thus reduce the chances of viability of the divested business. Additionally, VTG's comments at a hearing suggested to us that it would require work to be performed on wagons at outstations other than just their registered maintenance locations and so the VTG contract would increase the viability of the divested outstation business. We therefore do not consider that the VTG contract should necessarily be excluded from the divestiture.

Composition risks

- 8.34 When considering the composition risks of divesting only a part of the outstation network only we noted that:

- [REDACTED] Davis commented on the need for contracts to be formalized in advance of the divestiture. [REDACTED] We believe that there is a risk that if EWS retains both a central workshop facility and part of the outstation business then EWS could have the incentive and ability to seek to regain some of the customer relationships which had been included in the divestiture package, reducing the viability and competitiveness of the divested business.
- It was also put to us that, particularly given the informational asymmetry in favour of EWS, EWS may be able to 'cherry pick' Marcroft's most attractive contracts and outstations (in terms of, for example, the most profitable business relationships, or the outstations which gave access to the best infrastructure), thus reducing the viability and competitiveness of the divested business. EWS argued that it was unable to 'cherry pick' as it had signed hold-separate undertakings which only gave it access to very limited information about Marcroft's business. However we feel that EWS has a detailed understanding of the network and outstations, from its understanding of the industry as a whole, the due diligence it conducted as part of the acquisition process, its dealings with Marcroft between agreement to acquire it and completion of the merger, and its control of Marcroft prior to the undertakings coming into force. This detailed understanding of the business would enable EWS to identify and seek to retain the best contracts, locations and staff. From this EWS would be able to achieve competitive advantage in relation to divestiture, running the risk of reducing the viability of the divested business.
- Given the importance of a nationwide network to several significant customers, divesting a subset of outstations could result in some degradation of the network, its resulting attraction to customers and the viability and competitiveness of the divestiture.
- Splitting the outstation network would also increase the practical difficulties of separating and replicating support services for the divested network. The importance of this would, however, depend on whether the buyer had its own support services.
- EWS and a third party suggested that partial divestiture might increase competition in the outfield maintenance market by creating a third strong

competitor. However, this is largely dependent on the viability of the newly divested business.

- 8.35 EWS did not consider that it was necessary to divest all the Marcroft outstation business but rather only a subset of outstations necessary to service customers on a national basis. EWS considered that a suitable partial divestiture package would remove any pre-merger market power that we found Marcroft to have.
- 8.36 We consider the detail of EWS's proposal in paragraphs 8.55 to 8.63; however, we note that the key concern is to remedy the SLC or any adverse effects arising from it and create an appropriate divestiture package in order to do so. The divestiture package in the hands of the purchaser therefore needs to be viable with a competitive cost base, nationwide coverage and strong technical and management resources that will provide an alternative to Marcroft that can be expected to provide effective and sustained competition to the other firms in the market.¹⁰¹

Purchaser risks

- 8.37 We considered the purchaser risks for the divestiture of all or part of the Marcroft outstation business to identify whether a suitable purchaser would be likely to be available.
- 8.38 EWS suggested there may be few or no suitable purchasers, on the basis of the sale last year and the CC's own analysis. It thought that the companies that might be interested would be limited to Wabtec, Freightliner and Davis, and believed that there were issues with each:
- Wabtec would give rise to significant horizontal market power issues. If it acquired Marcroft its resulting share of the third party maintenance market would be around 90 per cent;
 - a sale to Freightliner would give rise to vertical SLC concerns similar to those we have raised concerning EWS;
 - Davis would not be a suitable buyer. EWS pointed to paragraph 6.167 of our provisional findings, where we stated that it was unclear whether finance would be available for companies wishing to grow to several times their original size.
- 8.39 With regard to Wabtec, we cannot predict the outcome of any future competition investigation, but we noted that if Wabtec acquired some or all of the outstation business its resulting market share would be up to 90 per cent (by number of wagons) or [X] per cent (by revenue).
- 8.40 With regard to a Freightliner purchase we note that there would be no impact on EWS of Freightliner owning the Marcroft outstation business because EWS does not use Marcroft to a significant extent at present. We also note that parties connected with the intermodal market, which do use Marcroft for their wagon maintenance, have raised fewer concerns over Freightliner owning the outstation business than with EWS owning it. DRS told us that the nature of its activities gave rise to little direct conflict with Freightliner within the intermodal segment of the market, as Freightliner concentrated on intermodal business from ports whereas DRS focused on intermodal business for consumer goods between inland sites (for which customers required

¹⁰¹Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8), December 2004, paragraph 4.27.

different size wagons).¹⁰² GB Railfreight said that they would be comfortable from an engineering perspective but were uncertain how the relationship would work from a commercial and competitive sense.

- 8.41 With regard to a Davis purchase of the outstations, paragraph 6.167 of the provisional findings referred to the difficulty that a small company would be likely to encounter in financing organic growth on this scale rather than growth through acquisition. Davis in total is reasonably substantial in the terms of this industry, with total annual sales of £8 to 10 million,¹⁰³ compared with £8 million for Marcroft's outstation business and £13 million for Marcroft as a whole. It also told us that it had been consistently profitable since an MBO in 1984; this provides evidence of strong management. Therefore we consider it likely that finance should be available for an acquisition of Marcroft's outstation business, and it would be easier for Davis to sustain a purchase of this sort than a rapid organic expansion of its business.
- 8.42 We considered other arrangements that would reduce any purchaser risks further. These involved increasing the pool of potential buyers, reducing the immediate competitive threat to the buyer (for example by requiring EWS not to compete for the customers of the divested business for a certain period of time) and achieving an acceptable timeframe for the process.
- 8.43 In order to increase the pool of potential buyers we would expect a wider marketing process to be undertaken for this divestiture than was the case when EWS acquired Marcroft, given that the marketing exercise which resulted in the sale of Marcroft to EWS was deliberately restricted¹⁰⁴ so that only five potential buyers were sent an information memorandum (see paragraph 3.1). [REDACTED]
- 8.44 Reducing the immediate competition that could occur between EWS and the divested outstation business would allow the purchaser time to develop as a viable entity. Davis told us that this should be a necessary part of the sale and purchase arrangements. EWS said that this was not necessary [REDACTED]. Two parties suggested that a non-solicitation agreement for transferred employees was not necessary, as losing staff to rivals and recruiting new staff was part of its normal activities. However, one party was a major and long-established competitor in the market and the other was a customer. Both may have had a different perspective to that of a new or small competitor. Competition from EWS could be either in the market or for employees. If part of or the entire Marcroft outstation business were sold we consider that [REDACTED]. However, any such agreement would be for EWS and the purchaser to negotiate as part of the Sale and Purchase Agreement.
- 8.45 To enable a suitable purchaser to be secured in an acceptable timescale the CC guidelines¹⁰⁵ state that we should set out in our report the period in which the parties should complete disposal of a divestiture package to a suitable purchaser (the initial divestiture period). This period may be excised from the report if it is considered that disclosure to third parties may undermine the divestiture process. If the merger parties cannot procure divestiture to a suitable purchaser within the initial divestiture period, then, unless this period is extended by the CC, an independent divestiture trustee may be mandated to dispose of the package within a specified period.

¹⁰²The two forms of intermodal haulage use different sized containers and DRS told us that customers and suppliers have limited opportunity for substitution.

¹⁰³Of which the majority of turnover comes from non-maintenance activities, such as wagon building.

¹⁰⁴See *Summary of a hearing with Alan Matthews*, paragraph 15, and *Summary of a hearing with Peter Opperman*, paragraph 19.

¹⁰⁵*Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8)*, December 2004, paragraphs 5.5, 5.6.

- 8.46 If a suitable buyer is not found after the divestiture process proceeded to a stage which required disposal through a divestiture trustee then the trustee would be empowered to seek a purchaser [X], subject to prior approval by the CC of the purchaser and the divestiture arrangements. The possibility of a sale on such terms may encourage interest from suitable purchasers in addition to those discussed above in paragraph 8.38.
- 8.47 From consideration of all of the above factors we concluded that it is likely that a suitable purchaser would be available for the divestiture of all or part of the outstation business.

Asset risks

- 8.48 It will be important for the divested outstation business to retain key staff and customers to maintain its competitive capability. [X] so it will be crucial that customer relationships are managed carefully by Marcroft before the sale and built up quickly by the purchaser after the sale to ensure that customers are content with the change in their maintenance provider following any divestiture. The risk of loss of key staff or customers may increase in the event of a partial divestiture of the outstation business.
- 8.49 The CC's divestiture guidance¹⁰⁶ states that where hold-separate undertakings are in place, the CC will usually require the appointment of an independent monitoring trustee to oversee the performance of the hold-separate manager and the party's compliance with the undertakings. The need for a trustee may be avoided if the CC can be satisfied that the hold-separate management will be appropriately independent. The trustee would have an overall duty to act in the interests of the viability and competitiveness of the divestiture. The trustee would oversee the ongoing management of the divestiture package and the conduct of the divestiture process and would have the right to propose and direct measures necessary to ensure compliance with the final undertakings. The trustee would report to the CC at regular intervals.
- 8.50 EWS signed interim undertakings with hold-separate provisions on the 13 March 2006. These will be replaced by hold-separate provisions specific to the circumstances of the divestiture in the final undertakings to implement a divestiture remedy.
- 8.51 EWS said that the appointment of a monitoring trustee would be unnecessary in this case because it had already identified what it considered to be a suitable divestiture package, it had already given hold-separate undertakings to the CC (ie in the interim undertakings) and had injected £[X] into Marcroft to ensure that Marcroft remained a going concern and had sufficient resources to remain a commercially independent operation.
- 8.52 The current circumstances of Marcroft and its management do not lead us to believe that hold-separate management will be appropriately independent in a process of divestiture so as to avoid the need for a monitoring trustee. The above points raised by EWS do not provide sufficient comfort on this matter. We consider that, in accordance with our guidelines and having regard to the circumstances of this case in which a partial divestiture is a possibility, a monitoring trustee should be appointed

¹⁰⁶Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8), December 2004, paragraph 5.4.

on terms agreed by the CC to help safeguard the viability of the divestiture package and an appropriate divestiture process.

- *Partial divestiture*

8.53 We considered whether a partial divestiture of the Marcroft outstation business would remedy the SLC and adverse effects identified. We have already considered the composition risks associated with such an option—see paragraphs 8.34 to 8.36. Our key concern is to create a divested business which remedies the SLC and its adverse effects by creating a business of sufficient size, with a sufficiently broad base of customers and with nationwide coverage to be a viable and competitive provider of wagon maintenance service, allowing it to offer its initial and potential customers the service they require.

8.54 We do not rule out a partial divestiture package, if an appropriate package and a suitable purchaser could be identified that create a strong third competitor in the market. However, as set out in paragraph 8.34, such a partial divestiture would give rise to concerns on which we would need to be satisfied. It is essential that sale of any subset of the outstation network is clearly sufficient to remedy the SLC and so it would need to create a competitor that would be viable on an ongoing basis. We recognize that the viability of the divested entity and the extent of the outstation business that would need to be sold to remedy the SLC would depend on the buyer and the resources and relevant experience and expertise it already possesses. It will be the responsibility of EWS and the proposed purchaser¹⁰⁷ to demonstrate that the latter satisfies our concerns regarding the viability of the divested entity and that the divested business in the hands of that purchaser remedies the SLC.

The EWS proposal for divestiture of part of the Marcroft outstation business

8.55 EWS proposed a partial divestiture package to us (the initial divestiture proposal) which it later modified (the modified divestiture proposal), for which it provided us with a financial projection and other clarifying information. It subsequently modified this further into a proposal which it told us had a potential purchaser interested (the final divestiture proposal). We set out the details of the initial and modified divestiture proposals, along with our analysis of them, in Appendix H. We were unable to conclude that either proposal would remedy satisfactorily the SLC and adverse effects arising from the merger.

8.56 On 29 August EWS provided us with its final divestiture proposal. It told us that [REDACTED] was prepared to enter into discussions with a view to acquiring the divested package set out in this proposal, subject to due diligence. This final divestiture package included the light in-field wagon maintenance for six customers: [REDACTED]. EWS told us that the divested entity would maintain 1,852 wagons, representing 26.2 per cent of the third party wagon maintenance market by number of wagons maintained. The divested entity would have 38 outstation staff and 17 vans for mobile units, based at five permanently-manned outstations.¹⁰⁸ When combined with [REDACTED] current operations the divested entity would become the second-largest third party wagon maintenance

¹⁰⁷ *Application of divestiture remedies in merger inquiries: Competition Commission Guidelines (CC8)*, December 2004, paragraph 3.1 states that 'In defining a divestiture package that will satisfactorily address the anticipated SLC, the CC will normally seek to identify the smallest operating unit of a business (eg a subsidiary or a division) that contains all the relevant operations pertinent to the area of competitive overlap and that can compete successfully on a stand-alone basis. Following discussion with the merger parties, the CC may modify the scope of the proposed divestiture package provided that the parties can demonstrate, to the CC's satisfaction, that the modified package addresses the SLC and the modification does not create significant composition, purchaser or asset risks after taking account of protective measures'.

¹⁰⁸ [REDACTED]

company in the market, with a [X] per cent market share (by number of wagons maintained). Following divestment, Marcroft would have approximately the same market share as the divested entity under [X] ownership, and Wabtec would have the largest market share. EWS told us that this package would address the composition, asset and purchaser risks we had identified, and provided updated financial analysis which, it told us, showed that the divested entity would make a substantial annual profit.

- *Assessment of the final divestiture proposal*

8.57 We consider that EWS's final divestiture proposal, if agreement on it is reached with [X], should, subject to the conditions below, remedy the SLC and adverse effects identified. We noted that the divested entity, under [X] ownership, would be about the same size (in terms of number of wagons maintained) as Marcroft; that Marcroft would, post-divestiture, be smaller than Wabtec and about the same size as the divested entity under [X] ownership; that wagon maintenance for [X] EWS's main competitors in the haulage market would transfer to the divested entity, preventing these customers from feeling the adverse effects of the merger identified in paragraphs 7.128 and 7.129; and that the divested entity would have six customers in addition to [X] existing customers, reducing its vulnerability to loss of any one customer. However, we did see some risks associated with implementing this proposal:

- the divestiture package would only be viable if all the large customers identified in the package agreed to the transfer. We do not know if this would be the case;
- EWS's proposal would be subject to due diligence conducted by [X] and the successful negotiation of contract terms;
- the proposal would be subject to EWS and [X] reaching agreement on a purchase price; and
- the proposal's financial projections were based on historical revenue streams, and we would want to see future projections to be content that the divested business could and would be operated successfully under [X] ownership.

8.58 However, the final divestiture package put to us appeared to have emerged from discussions between EWS and [X]. Should the sale to [X] not go ahead, the mix of contracts might be neither an attractive nor a suitable set of assets for a different purchaser to run as a viable provider of wagon maintenance services and competitor to Marcroft.

- *Conclusion on partial divestitures*

8.59 We concluded in paragraph 8.57 that EWS's final divestiture proposal may be sufficient to remedy the SLC and adverse effects arising, but that some risks remained. We concluded that we should see if EWS's final divestiture proposal could be implemented and whether more detailed evidence on the divestiture demonstrated that it would remedy the SLC and adverse effects identified. We conclude that:

- a monitoring trustee, paid for by EWS, will be required to monitor (without undue interference in commercial negotiations) the parties' actions during the negotiation of the divestiture process and to ensure the divestiture package is protected in accordance with the terms of the final undertakings;

- EWS should first seek to effect the final divestiture proposal or something broadly similar;
- the divestiture should, if required by [X], include relevant support services for the outstation business presently conducted from the Stoke location (including administrative support and engineering supervision) and access to the Stoke workshop for a limited transitional period (up to one year) to enable alternative arrangements to be set up for subcontracting and storage of materials;
- [X];
- EWS should guarantee [X] access rights to any transferred sites¹⁰⁹ on reasonable terms and undertake to renew leases on transferred sites (where applicable) on appropriate terms. In addition, where EWS has influence over the access to other sites used by Marcroft, for example through controlling lines over which wagons must travel to reach a maintenance location (even if EWS does not control the maintenance location itself), EWS should continue to provide access at the same or no worse than current terms;
- following due diligence, EWS shall request that [X] provide us with business plans for the divested entity so that we can be satisfied that the divested entity would be able to act as an effective and financially viable competitor in the wagon maintenance market offering national coverage;
- the monitoring trustee should report to us every two weeks for a period of up to [X] (the initial divestiture period), advising on the progress of discussions with wagon maintenance customers identified in the final divestiture proposal, and negotiations with [X]; and
- if at any point the monitoring trustee believed that the final divestiture proposal was unlikely to be implemented within the initial divestiture period he should report this to us, along with his reasons for believing this to be the case.

8.60 If the monitoring trustee advises that that the final divestiture proposal is unlikely to be implemented within the [X] initial divestiture period, or that period expires without agreement by [X] to acquire the package identified in the final divestiture package, then the CC will consult the monitoring trustee about the progress of negotiations and, unless satisfied that negotiations will conclude successfully in the near future, will formally notify EWS that the implementation of the final divestiture proposal is to be halted.

8.61 If the process for implementation of the final divestiture proposal is halted then:

- EWS should invite bids for all or part of the outstation business, to allow potential purchasers to identify the scope of the divested business they would need to create a viable national provider of wagon maintenance services, having regard to the scale and nature of the purchaser's existing business. EWS considered that requiring it to invite bids simultaneously for all or part of the outstation business could result in bidders 'gaming' the divestiture process with the result that the divestiture would be greater than if bids for only part of the business were invited at the outset. We note that EWS would have the option of accepting bids for part of the business in preference to the whole provided this remedied

¹⁰⁹Marcroft has leases for six EWS sites for maintenance and pays a rent to EWS for the use of five of them. Marcroft also uses a further 18 sites controlled by EWS to maintain wagons.

the SLC. We also note that only offering part of the business at the outset could increase composition risk for reasons outlined above and/or cause significant delay to divestiture with attendant harm to the divested business and delay in addressing the SLC. We therefore do not consider that requiring simultaneous offering of the whole and part of the outstation business is unreasonable;

- the divestiture should include relevant support services for the outstation business presently conducted from the Stoke location (including administrative support and engineering supervision) as necessary and should preserve access to the Stoke workshop for a limited transitional period ([REDACTED]) if required by a suitable purchaser to enable alternative arrangements to be set up for subcontracting and storage of materials;
- if a subset of outstations were sold, [REDACTED]; and
- EWS should guarantee the new owner of the outstation business access rights to any transferred sites¹¹⁰ on reasonable terms and will undertake to renew leases on transferred sites (where applicable) on appropriate terms. In addition where EWS has influence over the access to other sites used by Marcroft, for example through controlling lines over which wagons must travel to reach a maintenance location (even if EWS does not control the maintenance location itself), EWS should continue to provide access at the same or no worse than current terms.

8.62 We considered how long EWS should be given to effect the disposal of the whole, or part, of the outstation business. EWS told us that it considered [REDACTED] to be sufficient time. Given that the sale might involve splitting the outstation business (see paragraph 8.61) we consider that the longer period suggested by EWS, [REDACTED], would be appropriate. If EWS cannot procure divestiture of the outstation business within this period either the period could be extended by the CC or an independent divestiture trustee would be mandated. The role of a divestiture trustee would be distinct from that of the monitoring trustee, but if the divestiture trustee were to be required the two roles could be performed by the same person or organization.

8.63 We conclude, therefore, that the divestiture of part of the Marcroft outstation business could be an effective remedy to the SLC and adverse effects identified, subject to EWS demonstrating to our satisfaction that either the EWS final divestiture proposal or another specific proposal would satisfactorily address the SLC and not be subject to significant composition, purchaser or asset risks. This would involve satisfying the criteria and conditions set out in paragraphs 8.59 or 8.61.

Relevant customer benefits

8.64 Having considered what action is necessary to remedy the SLC or adverse effects arising, we now turn to the effect of this action on any relevant customer benefits arising from the merger

8.65 EWS suggested that a customer benefit resulting from EWS's acquisition of Marcroft was that it was the only outcome that preserved the Stoke workshop. EWS noted that this was on the basis of the CC's own case as set out in the provisional findings. EWS suggested that the continued existence of that workshop and its availability to customers can only lead to increased choice and competition for customers of

¹¹⁰Marcroft has leases for six EWS sites for maintenance and pays a rent to EWS for the use of five of them. Marcroft also uses a further 18 sites controlled by EWS to maintain wagons. Such access rights should include the access to, and use of, the [REDACTED].

workshop services, to the maintenance of existing levels of capacity, and therefore to the continuation of existing levels of price competition.

- 8.66 The relevant customer benefits (which are considered under section 35(5) of the Act, see paragraph 8.5) are set out in the section 30(1) of the Act and relate to benefits in the form of lower prices, higher quality, greater choice and greater innovation. The counterfactual, as set out in paragraph 6.29, is that the Stoke workshop would have been lost. EWS concurred with our assessment that there is an excess of workshop capacity.¹¹¹ This conclusion was also supported by two other parties (although one respondent argued there would be a shortage of capacity if the Stoke workshop closed and one argued that whilst there may have been some excess workshop capacity it is not available capacity). We consider that, because the Stoke facility is a rail connected workshop, there might be some benefits to customers resulting from the acquisition. However, we do not consider the retention of the Stoke workshop is such a significant relevant customer benefit that it should influence the conclusions on the questions which the CC is required to consider (see paragraph 8.2).

Decisions on the Statutory Questions

- 8.67 In light of the above and in answer to the questions set out in section 35(3) of the Act:
- (a) the CC does consider it necessary to take action to remedy, mitigate or prevent the SLC and the adverse effects identified in the conclusions in paragraph 7.181;
 - (b) the CC does not think it is appropriate to recommend the taking of action by others; and
 - (c) having regard to the need to achieve as comprehensive a solution as is reasonable and practicable,¹¹² the CC considers that a divestiture of all or, subject to the requirements set out in paragraphs 8.59 to 8.62, part of the outstation business would be sufficient to remedy the SLC and the adverse effects arising from it.

Conclusion on remedies

- 8.68 We conclude that there are no behavioural remedies that are likely to remedy adequately the SLC or adverse effects identified.
- 8.69 We conclude that EWS should be required to seek to give effect to its final divestiture proposal (or something broadly similar to it) with [X], and that if it is unable to do so within the initial divestiture period, EWS should be required to invite offers for the disposal of the whole or part of the Marcroft outstation business. Any partial divestiture package is to be subject to approval by the CC to ensure it satisfactorily addresses the SLC and adverse effects identified, and would not be subject to significant risks.

¹¹¹EWS submission to the CC, paragraph 4.18.

¹¹²Section 35(4) of the Act.