

EWS's initial and modified divestiture proposals

1. This appendix sets out the initial and modified divestiture proposals put forward by EWS, and our analysis of their effectiveness in remedying the SLC and adverse effects identified in our report.

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

2. EWS proposed a partial divestiture package to us (the initial divestiture proposal) which it later modified and provided us with a financial projection and other clarifying information (the modified divestiture proposal), and subsequently modified further into a proposal in which it told us a potential purchaser had expressed an interest (the final divestiture proposal). In this appendix we focus on the first two of these proposals.
3. EWS initially proposed a package which included staff operating from [redacted] locations,¹ with [redacted] mobile teams operating from [redacted] out of these [redacted] locations.² A total of [redacted] Marcroft staff based at these locations would be transferred, which included [redacted] per cent of Marcroft's skilled outstation fitters. These would provide wagon maintenance services for three customers: [redacted] EWS noted that this represented the majority, but not all, of [redacted] work and splitting the business in this way would be subject to this customer's approval. EWS told us that it did not believe that [redacted] wagon maintenance requirements among several maintainers would cause any detriment to this customer's business, as it currently uses a number of different wagon maintenance operators to service its fleet. EWS told us that the wagon maintenance for the three customers would be carried out at the same locations as at present, and so they would not notice any difference.³ EWS told us that the package it proposed included mobile teams at locations which would allow the divested entity to offer national coverage for wagon maintenance. It also told us that, by working more efficiently, the divested entity could fulfil the work for [redacted] with the equivalent of [redacted] staff, potentially leaving the capacity of [redacted] staff to service new contracts. The divestiture package would also include the [redacted] EWS also told us that there were possible variants to its proposal.
4. When it presented its initial divestiture proposal EWS told us that its proposal would give the divested business maintenance work for [redacted] wagons, equating to a [redacted] per cent share of the wagon maintenance market (by number of wagons). Marcroft would retain work for maintenance of [redacted] wagons, which equated to a [redacted] per cent market share for wagon maintenance (by number of wagons). Marcroft would retain [redacted] permanently manned outstations and approximately [redacted] mobile units. Marcroft would keep around [redacted] outstation staff and around [redacted] staff based in Stoke, either at the workshop or in administration, sales, technical support and management roles, though some of these staff working predominantly in support of the outstation business could transfer to the divested entity if required. EWS told us that the reduction in Marcroft's market share from [redacted] to [redacted] per cent would remove any pre-merger market power the CC believed it had.

¹[redacted]
²[redacted]

³Marcroft told us that it was common for a wagon to be maintained by an engineer with specialist skills in that wagon type, who would travel to a location to perform the maintenance even if the location was manned by other Marcroft staff.

5. EWS said that this initial divestiture package would constitute a viable business capable of operating independently of EWS and Marcroft and of providing effective and sustained competition in the wagon maintenance market on a national basis within a year, but provided no financial analysis of the package to be divested to show how it reached this view.
6. Subsequently, EWS provided a modified divestiture proposal, with a modified package of assets and including a financial projection. EWS revised its estimate of total wagons subject to repair by the divested entity from [REDACTED]. The customers to be included in the divestiture were unchanged. EWS revised the number of staff to be divested with the business from [REDACTED] and the number of vans to be divested from [REDACTED]. The increase in staff was due in part to the identification of additional work on [REDACTED] wagons which required [REDACTED] additional staff at [REDACTED]. The remaining increases in staff were spread over other locations. EWS stated that it would be willing to enter into [REDACTED].
7. EWS provided a financial projection for the divested entity which was based on actual revenues, direct material and labour costs for the previous 12 months on work for the [REDACTED] customers to be divested. These were then combined with an estimate of the overheads for the [REDACTED] proposed outstations. The resulting projection for the divested entity showed an annual turnover of £[REDACTED] million and a contribution after outstation overheads (but before central overheads) of £[REDACTED] million. On the basis of this projection, EWS told us that the entity would have the [REDACTED] largest market share in terms of revenue in the in-field third party wagon maintenance market of [REDACTED] per cent⁴ ([REDACTED] per cent by number of wagons maintained) compared with [REDACTED] per cent for Marcroft (by number of wagons maintained).

Assessment of the initial and modified divestiture proposals

8. We assessed whether the initial and modified divestiture proposals put to us by EWS would remedy the SLC and adverse effects arising from the merger. We focused on the modified divestiture proposal, as this included the larger divestiture package. If it was not clear that this package remedied the SLC and adverse effects then the smaller divestiture package would also fail to be a suitable remedy.
9. We considered EWS's proposals carefully. We believe that the appropriate level of divestiture will depend on satisfactorily addressing the risks outlined in paragraphs 8.34 to 8.52 of the main report. Further, the appropriate level of divestiture will depend in part on the assets held by, and wagon maintenance work already carried out by, and the financial strength and relevant expertise of, the acquirer of the divested business.
10. On the evidence available to us, we could not conclude that the modified divestiture would, as EWS argued, remove any pre-merger market power we believed it had. We noted that Marcroft's market share would reduce from 56 per cent to [REDACTED] per cent (or [REDACTED] per cent as amended) under EWS's proposal. Whilst its market share had fallen in absolute terms and relative to Wabtec, it would still be the largest wagon maintenance provider in a market characterized by two players with significant market shares, with an additional third player (the divested entity) having around half Marcroft's market share by number of wagons maintained. Further, we could not

⁴We noted that this figure covered revenue for in-field maintenance only. We were unable to calculate accurately in-field revenues separately from workshop revenues and were therefore unable to calculate the size of the in-field maintenance market by revenue. Hence we were unable to verify the market share figure calculated by EWS, or calculate comparable market shares for the other wagon maintenance companies. We noted that by number of wagons maintained the divested entity would have the third largest market share.

conclude that the market would have the features which would prevent Marcroft from exercising the degree of market power that might be expected from its market share (see paragraph 7.26 of the report).

11. On its own, the divested entity may not have the scale, coverage and resources necessary to remedy the SLC effectively. In particular:
- It was not clear to us that the divested entity on its own would have the scale to be perceived by potential customers as a viable business capable of operating independently of EWS and Marcroft and of providing effective and sustained competition in the wagon maintenance market. We had reservations about whether an entity (using the EWS figures) of around half the size of the remaining Marcroft business and only just over half that of Wabtec by number of wagons maintained would be competitive, as it might be lacking sufficient economies of scale. This would reduce its ability to develop as an effective and sustained competitor to the other firms in the market and the likelihood that it would provide independent, effective and sustained competition to the remaining business.⁵ We noted that the scale disadvantage of the divested entity could be reduced to some extent if it were acquired by an existing small operator in the wagon maintenance market.
 - A business with only three customers, each of whom had only a limited contractual commitment to the divested entity, could be seen as high risk by potential purchasers, with the ongoing viability of the business vulnerable to the loss of one of any of these three customers. We considered that a more diversified customer base and/or a greater contractual commitment could be required by a purchaser to overcome this risk. EWS argued that customers forming part of the divestiture package would be willing to enter into formal contracts with the purchaser of the business and this, in conjunction with the non-compete and non-solicitation obligations that EWS was willing to offer, should meet the CC's concerns. However, we noted that given the general absence of formal contracts (see paragraphs 7.9 and 8.34 of the report) and the circumstance of transferring work to a new and relatively untested entity, we could not necessarily expect customers to commit to formal contracts for most of their work following divestiture.
 - It was unclear to us that [X], one of the three companies that EWS suggested would provide some of the wagons to be maintained by the divested entity, would agree to a part of its business being transferred to the new entity. Moreover, as the divested entity would only provide maintenance services for some of [X] wagons, this customer might be more likely to consider switching back to Marcroft as a single principal maintenance provider if faced with any problems, for example teething problems during the start-up phase of the new business.⁶ We also believed that it would be difficult to frame a non-compete clause that would satisfactorily address a situation where part, but not all, of a customer's business was subject to a non-compete obligation.
 - We were unable to conclude that the EWS proposal provided adequate coverage nationwide, a requirement which had been identified as key (see paragraph 7.48). We noted EWS's comments about how the mobile teams of the

⁵As required by our guidance (*Merger References: Competition Commission Guidelines (CC2)*, paragraph 4.27) and noted in paragraph 8.22 of the report.

⁶We also noted that the divestiture package proposed by EWS did not include the wagon maintenance work carried out for [X], one of EWS's rivals in the haulage market and therefore a company we expected to feel the adverse effects of the merger we have identified in paragraphs 7.128 and 7.129 of the report.

divested entity would be located so as to offer national coverage. However, this coverage depended on retaining the work transferred to the divested entity; for example, the divested entity's ability to offer coverage in Wales and the South-West appeared to be entirely reliant on its keeping the work from [X]. The number of permanently-manned outstations and mobile teams was significantly smaller than in either the Marcroft or Wabtec networks. We were also unclear whether, whilst the divested entity would have a geographic spread across Great Britain, its network density would enable it to respond quickly and efficiently to the maintenance needs of both its existing customers and potential new customers. However, we acknowledged that the network disadvantage of the divested entity might be reduced to some extent if it was acquired by an existing operator in the wagon maintenance market.

- EWS has provided a financial projection which, it stated, showed that the divested entity should be profitable. We examined the financial projection and noted that:
 - the turnover, direct labour and material costs in the projection were historical figures. However, we saw no assumptions, or evaluation of assumptions, that enable us to conclude that these figures provide a sound basis for future projections; and
 - since only part of [X] was included in the divestiture it was difficult to assess whether the proportion of its maintenance spend attributed to the divested part of the business was accurate and represented a realistic steady-state revenue to be generated from this customer.
12. Given these uncertainties we believed that there was a risk that the divested entity might not be viable, particularly as it attempted to develop as an effective competitor in the market.
13. We were unable to conclude, therefore, that the modified divestiture proposal would remedy satisfactorily the SLC and adverse effects identified. We similarly found, therefore, that we were unable to conclude that the initial divestiture proposal would remedy satisfactorily the SLC and adverse effects identified. We did not expect that we could be fully satisfied as to the merits of any particular partial divestiture package without knowing what assets, facilities, staff and customers would be brought to the divested entity by a potential acquirer, and without having access to the level of detailed analysis that would be conducted by a potential purchaser prior to acquiring a business.