FirstGroup: ScotRail Franchise

Competition Commission merger inquiry

Opening submissions of FirstGroup plc

1 Introduction

1.1 This is the non-confidential version of the Opening Submission of FirstGroup plc ("First") to the Competition Commission in connection with First's bid for the ScotRail franchise, currently operated by ScotRail Railways Limited, a subsidiary of National Express. First's bid was the subject of a merger reference by the Office of Fair Trading ("OFT") on 13 January 2004 pursuant to powers under section 33 of the Enterprise Act 2002.

1.2 Further explanation of the competitive bid process for the ScotRail franchise and rationale for the bid is contained in Appendix 1. Background information on First, including a brief description of its principal activities in the UK, US and Europe is set out in Appendix 2, with brief details of its operations in Scotland in Appendix 3. Some information on the ScotRail network of services is contained in Appendix 4. A history of the dealings between First and ScotRail is set out in Appendix 5.

1.3 The terms of the reference refers to the Competition Commission the question of whether the proposed acquisition may be expected to result in a substantial lessening of competition in the market for the supply of **passenger transport services on point-to-point routes in Scotland**. This Submission therefore concentrates on the parties' activities in the passenger transport market in Scotland and where their activities geographically overlap.

1.4 In the OFT's decision to refer ("the OFT's Decision"), it concluded that "**it did not consider that it is or may be the case that the merger may be expected to lessen competition substantially as between rail operators**". This Submission does not therefore deal with rail/rail issues or any changes in the structure of the rail industry.

1.5 The remainder of this Submission is organised as follows:

Section 2	Executive Summary
Section 3	Markets relevant to the reference
Section 4	Geographic overlap between First and ScotRail
Section 5	Regulation in the relevant markets
Section 6	Competition to First – actual and potential
Section 7	Barriers to entry and expansion
Section 8	Assessment of the effects of the merger on competition

2 Executive Summary

2.1 The terms of reference refers to the Competition Commission the question of whether the acquisition, if First should win the ScotRail franchise, may be expected to result in a substantial lessening of competition in the market for the supply of passenger transport services on point-to-point routes in Scotland.

2.2 Whilst there are some 787 point-to-point flows on rail routes operated by ScotRail where a First bus travels between the same points, further analysis of those flows leads to the conclusion that post-merger First would not be able to exploit its position to the detriment of the passenger.

2.3 Rail is heavily regulated. Service levels are dictated under the terms of the ScotRail franchise and First could not reduce them without being in breach of the franchise agreement. Fares are regulated by the SRA throughout Scotland and in the Strathclyde area are set by Strathclyde PTE. In Strathclyde therefore, First will have no ability to manipulate competitive conditions in respect of rail services, and outwith Strathclyde will have little or no commercial freedom either.

2.4 In the OFT's Decision, the OFT raised the concern, expressed by some competitors, that First could alter bus prices or reduce service frequencies to induce passengers to switch to overlapping rail services to increase overall revenue. The following constraints would prevent First from pursuing such a hypothetical strategy post-merger:

(a) **Rail and bus are in different product markets** – previous findings of the competition authorities have concluded that different transport modes tend to be complements rather than substitutes: bus and rail are poor substitutes because the characteristics of both are very different. There is therefore no concern about a particular flow if competition between bus and rail is so weak that they are in different markets. On analysis, First considers that of all the overlap flows, 78% can be discarded on that basis (including de minimis flows), leaving overlap flows that account for merely, First estimates, ***[confidential information]*** of its relevant revenue in Scotland[1] and ***[confidential information]*** of ScotRail's total turnover[2]. Therefore, even if there were an element of substitutability on specific flows these flows would be small in the context of the parties' networks as a whole.

(b) **There are significant competitive constraints from other bus operators** – since 1996 (when the then MMC considered the FirstBus/SBH merger) the levels of competition faced by First have increased significantly across central and south east Scotland. For example, ***[confidential information]*** of First Glasgow's on-bus revenue comes from services where it faces competition from another operator over some part of its route.

There is no concern about a flow if competition from other bus operators will constrain post-merger behaviour. This will be the case where there is already a competing operator on the flow or a competing operator could easily extend its network to cover the flow. Further analysis shows that out of all the overlap flows, First already faces competition from another bus operator on 53% (in number) of the flows and that First faces potential entry on all the remaining flows if First should increase fares/reduce service quality or withdraw routes.

[confidential information]
[confidential information]

(c) **First has no incentive to engage in a strategy of inducing passengers to switch from bus to rail**:

- There are constraints from other flows on the same route and from the network that mean First cannot change fares and service levels on a particular flow without disrupting the rest of the route, and other parts of the network. For example, any change to the service levels (or quality) on one flow will affect First's revenues from the whole route (covering many flows), so that commercial decisions about service levels (and fare prices) cannot and will not be made at the level of individual flows.

- First, in the vast majority of cases, already faces competition from other bus or coach operators on at least some part of the route and would risk losing passengers to that competitor.

- First has no incentive to engage in the strategy where the bus fare is already higher than the train fare. Of the routes considered by the OFT, ***[confidential information]*** of the Edinburgh flows and ***[confidential information]*** of the Glasgow flows at off-peak times and ***[confidential information]*** of the Edinburgh flows and ***[confidential information]*** of the Glasgow flows at peak times fall into this category.

(d) **Where rail revenue is shared with stakeholders there is no incentive to divert passengers** – whilst revenue risk has yet to be decided on by the stakeholders, First believes that at the very least the franchise will be subject to a revenue share arrangement, reducing the incentive to undertake the hypothetical strategy.

(e) **The Undertakings prevent selective bus price increases** – First is the subject of fare undertakings that effectively mean it cannot raise fares on individual flows in the whole of central and south east Scotland[3].

(f) **Capacity on rail is constrained** – First has no incentive to divert passengers to rail in those cases where the ability of rail to carry more passengers is constrained.

2.5 In the OFT's Decision, the OFT concluded that there appeared to be "considerable weight" to the arguments advanced by First and set out in this Submission. The OFT stated in its Decision, "**The constraints First identifies…would seem largely to frustrate a hypothetical strategy of inducing passengers to switch to rail. It is probably that the number of routes that would escape these constraints would be small. As a result, any extra revenue gained would be relatively low, thus weakening the incentive to adopt such a strategy**.".

[3] Excluding the City of Edinburgh.

3 Markets relevant to the reference

ScotRail's passenger rail operations

3.1 An outline of ScotRail's activities is set out in Appendix 4 together with a map of the network operated by ScotRail. ScotRail has only passenger rail interests, it does not operate any bus services.

3.2 The ScotRail franchise is responsible for the operation of approximately 95% of the passenger rail services in Scotland, of which approximately 50% are operated on behalf of the Strathclyde Passenger Transport Executive ("SPTE"). The services provided include:

- Strathclyde services in west central Scotland centred on the Glasgow conurbation provided for SPTE;
- inter-urban services between major Scottish cities;
- urban services, principally in and around Edinburgh;
- sleeper services; and
- rural services in the north and west Highlands, north east Scotland and south west of Scotland.

First's bus operations in Scotland

3.3 An outline of First's principal activities is set out in Appendix 2. Within Scotland, First has only bus operations, it does not have any passenger rail interests. First operates bus services in Scotland through the following four subsidiaries:

First Aberdeen	Bus services within the City of Aberdeen
First Edinburgh	Mainly inter-urban services in the Edinburgh, Lothian areas (East Lothian, West Lothian and Midlothian), and the Borders. Also mainly rural bus services in and around the Stirling and Falkirk areas
First Glasgow (No 1 and No 2)	Services in the City of Glasgow and surrounding areas, all within Strathclyde

3.4 Further brief details of those subsidiaries are given in Appendix 3.

3.5 In the OFT's Decision, the OFT did not consider the region of Aberdeen, "since there is only one overlapping route and the bus journey time significantly exceeds that of train on that route". Similarly this Submission does not consider in any detail First's operations in the Aberdeen region. Rather it concentrates on the geographic areas in which First Glasgow and First Edinburgh operate.

Geographic market definition

3.6 The relevant geographic markets are point-to-point routes. Of these, the only ones that are potentially affected by the proposed merger are point-to-point routes that are served by both First and ScotRail.

Point-to-point routes

3.7 The Competition Commission merger guidelines set out the test for defining relevant markets: "*the products that should be included in the relevant market, and the geographic boundaries of that market, are determined by 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 key to market definition is substitutability.*"[4]

3.8 In the present case consideration of substitutability shows that the relevant geographic market is a point-to-point route. A passenger wanting to travel from A to B will not generally consider a journey from C to D as a substitute. As the OFT has noted, "*it is unlikely that bus users would switch between routes in response to fare increases*".[5]

3.9 This definition of the geographic extent of the market is consistent with previous analysis. In all merger cases involving rail, bus or coach services since 1996 the OFT and Competition Commission have analysed the impact of the transaction on the basis of overlapping point-to-point routes.[6] For example, in the National Express/Midland Main Line inquiry in 1996 the MMC "*concentrated in this inquiry on the effects of the merger on the services between central London and the five specified places*".[7]

3.10 Rather than taking into account supply side considerations in the analysis of market definition, they are addressed during the analysis of potential entry. This is consistent with Competition Commission guidelines.

Catchment areas

3.11 There is a possible exception. Two different point-to-point routes may be in the same market if they start close to each other (in the same catchment area) and end in the same catchment area. This situation is described by means of an example by the ORR in the context of rail. "*If sufficient numbers of consumers viewed a trip by rail from London Euston to Birmingham New Street as a substitute for a trip by rail from London Marylebone to Birmingham Snow Hill…the [two trips] would be in the same relevant market*."[8]

Product market definition

3.12 Different transport modes tend to be complements rather than substitutes. Even on point-to-point routes where passengers can in principle choose between bus and rail, the characteristics of the two are so different that they are often poor substitutes. The possible point-to-point routes where rail and bus compete in the same product market are those where, *inter alia*, the journey times, reliability, frequency and fares and other journey characteristics are sufficiently similar.

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[4] Competition Commission (2003), "Merger References: Competition Commission Guidelines", June. Available at http://www.competition-commission.org.uk/.

[5] OFT, *The Transport Act 2000 and The Transport (Scotland) Act 2001: Guidance on the Competition Test*, October 2003. Paragraph 2.7. Available at http://www.oft.gov.

[6] See MMC reports on cases National Express Group/Midland Main Line (1996), FirstBus/S B Holdings (1997, for non-tendered services), National Express Group/ScotRail (1997), National Express Group/Central Trains (1997), as well as OFT merger decisions on cases Govia/South Central (2001), FirstGroup/GB Railways (2003) and FirstGroup/ScotRail (2004).

[7] MMC report on National Express Group plc/Midland Main Line Ltd, December 1996 (point 2.34). The term 'services' is equivalent to 'routes'.

[8] ORR, *Application to services relating to railways*, Competition Act 1998 guideline, November 2002 (point 3.4). Available at http://www.rail-reg.gov.uk.

Train and bus

3.13 In general bus and train networks are complements, not substitutes. The MMC in its report on National Express/Central Trains, reported that "*Dr Glaister, on behalf of the Rail Regulator, said that…the two modes tended to do rather different jobs in urban areas, being complementary rather than competitive.*"[9]

- **Route network:** As the Competition Commission accepted in the National Express/Central Trains inquiry,[10] one reason why bus and rail do not compete is that they serve different routes. Bus networks are far more comprehensive than rail – the vast majority of bus routes are not served by rail.

- **Journey time and congestion**. The characteristics of the two modes are very different, even on the same point-to-point route. In its decision on FirstBus/SBH the MMC noted that "*the different characteristics of rail and bus travel, particularly relative frequencies, journey times, relative prices and the location of bus stops and stations, it does not follow that passengers regard these two modes as competitive alternatives*"[11]. In relation to the National Express/Central Trains transaction the MMC went on to note that "*typically, journey times are very much longer by bus (although in some cases this may be offset to some extent by lower waiting times due to higher-frequency of service) and bus punctuality may be adversely affected by traffic congestion.*"

- **Journey purpose:** The differences in characteristics leads train and bus to be used for different purposes. The National Express/Central Trains report noted that: "*NEG told us that train journey lengths averaged 10km, as compared with 4.5km for buses. Other data submitted by NEG showed that rail travel is more concentrated in the peak (60% compared with 44% for bus); that a higher proportion of rail travel is for travel to work.*"[12] Additional evidence comes from the ScotRail Franchise Bid Report prepared by ***[confidential information]*** (a copy of which the Competition Commission has). That report notes that, ***[confidential information].***

- **Passenger type:** Finally the differences mean that the passenger profiles for bus and rail are different. Referring to evidence from NEG presented during the National Express/Central Trains investigation, the MMC notes that "*a higher proportion of bus travel is accounted for by women and lower socio-economic groups*".[13]

3.14 What this means in practice is that the extent of substitution between rail and bus (and consequently whether the two are in the same market) will depend on the details of the particular point-to-point route: whether both are options on that route, the difference in journey time, frequency of service, the risk of congestion, fares, and so on. In many cases the differences will give one mode a decisive advantage. Most notably, on many point-to-point routes served by both rail and bus, the rail journey is so much quicker and more reliable that there is effectively no competition between bus and rail.

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[9] MMC Report on National Express Group plc/Central Trains. Available at http://www.competition-commission.org.uk/.
[10] Cm 3774, December 1997.
[11] MMC Report on FirstBus plc/S B Holdings. Available at http://www.competition-commission.org.uk/.
[12] MMC Report on National Express Group plc/Central Trains, op. cit.
[13] MMC Report on National Express Group plc/Central Trains, op. cit.

Train and coach

3.15 Coach is an effective substitute for rail on the routes where they overlap. This has been acknowledged by the MMC in a number of reports: "*Although we accept that rail services would seem to provide stronger competition to coach than coach services to rail, we believe that in the light of all the evidence summarized above coach services can also be regarded as providing an element of competition to rail services. Competition between coach and rail is therefore in our view a factor to be taken into account by management in making decisions on fares and quality of service for both the coach and rail reference services*"[14].

3.16 A number of studies have found significant cross elasticities between rail and coach: "*While rail and coach are generally regarded to be reasonably close substitutes and to compete in the same market of non car owning travellers, the cross elasticities do tend to be higher than we had expected*"[15].

Car and other transport modes as an alternative to train

3.17 The option to use a car is a constraint on train fares. As the MMC acknowledged in National Express Group plc/Midland Main Line: *"evidence of cross-price elasticities between car and rail support the view that, looked at in aggregate, some competition takes place between these two modes."*[16] This is confirmed in the ScotRail Franchise Bid Report: *"private car usage is the main competitive threat to ScotRail."* ***[confidential information].***

Car and other transport modes as an alternative to bus

3.18 Train is <u>not</u> the only alternative to bus as a way to make a journey. Passengers may also be able to use a car, walk, cycle, or use a taxi. As with train, these alternatives will not always be strong substitutes and their impact will depend on the journey and the type of passenger: car is potentially a good substitute for those that own one; walking may be an alternative for younger passengers on short point-to-point routes; taxi can be an alternative for journeys home from the supermarket, when the convenience of not having to carry heavy bags may outweigh the additional cost. Even if these limitations mean that these alternative modes are not generally in the same relevant market, they nevertheless offer a constraint, and their availability will affect the profitability of changing service levels and fares on buses.

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[14] MMC Report on National Express Group plc/Midland Main Line, December 1996, pp. 2.40 and 2.48. The same conclusion is reached in National Express Group plc/Central Trains, 1997, and National Express Group plc/ScotRail, 1997.

[15] Wardman, M. (1997), "Disaggregate Urban Mode Choice Models: A Review of British Evidence with Special Reference to Cross Elasticities", Institute for Transport Studies of the University of Leeds, Working Paper 505, July. Available at http://www.its.leeds.ac.uk/working/downloads/WP505.pdf.

[16] MMC Report on National Express Group plc/Midland Main Line ltd, December 1996, (point 4.79).

4 Geographic overlap between First and ScotRail

4.1 First has for the purpose of analysing the competitive effects of the proposed merger adopted an approach consistent with that used in previous merger cases involving the passenger bus and rail sectors and has focused on the extent to which there is geographic overlap between the parties' services. The question of the extent of competition been bus and rail has been looked at on a point to point basis. This is also consistent with the conclusion reached in the OFT's Decision that, "The relevant frames of reference for assessing the competitive effects of this merger are considered therefore to be the supply of passenger transport services on point-to-point routes in Scotland".

4.2 In determining whether there is any geographic overlap between the bus services of First and ScotRail, First has taken the network operated by ScotRail as a starting point (map attached at Appendix 4). First has then compared the ScotRail network generally with First's bus operations in Scotland. Geographic overlap between bus and rail arises in three areas:

- Aberdeen;
- Central Scotland and the Lothians (including Edinburgh); and
- the City of Glasgow (and immediate surrounding area, all within Strathclyde).

Route overlaps

4.3 The starting point for the analysis was to consider which of ScotRail's point to point flows[17] could theoretically be served by a direct First bus service, regardless of whether the routes taken by bus and rail mirror each other. That exercise is simply a fairly rough and ready analysis resulting in a list of rail routes where <u>in the broadest sense</u> a bus alternative theoretically exists. These lists (one each for First Aberdeen, First Edinburgh and First Glasgow[18]) are attached in Appendix 7. We will discuss in more detail in the Sections that follow, the reasons why the existence of overlaps does not necessarily mean there is a competition concern.

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[17] We use the term "flow" as a journey between two points.
[18] We use the term First Glasgow to include First Glasgow (No 1) and First Glasgow (No 2).

5 Regulation in the relevant markets

5.1 In considering the competitive impact of the acquisition of the ScotRail franchise by First it is vital to understand, and take into account, the role of rail regulation and the level of control that the stakeholders will have over the fares and service levels to be operated by the franchise. This was acknowledged in the OFT's Decision.

5.2 The stakeholders in the ScotRail franchise (SRA, SPTE and Scottish Ministers) will have a considerable level of control over the franchise particularly in the Strathclyde area. In the NEG/Central inquiry, where the relevant PTE (Centro) set the rail fares and service levels, the MMC concluded[19] that to the extent that rail services were substitutable for WMT's bus services on the overlap routes, therefore the competitive constraint which the rail services presented could not be relaxed by NEG unilaterally. Likewise, in NEG/ScotRail the MMC[20] had no concerns about the overlap between Citylink and the services that ScotRail provided for SPTE since NEG had no ability to manipulate competitive conditions in respect of those services due to the strict level of regulation. This will continue to be the case in the new franchise.

5.3 As well as regulation of the ScotRail franchise, First are currently subject to behavioural undertakings ("the Undertakings") affecting its bus operations in central and south-east Scotland (including its operations in Strathclyde). The Undertakings were required following First's acquisition of SB Holdings Limited ("SBH") in 1996 which was the subject of a reference to the then MMC. Further commentary on the reference, the background to the Undertakings and the effect of the Undertakings themselves are contained in Appendix 6.

5.4 The Undertakings broadly:

(a) restrict First's ability to raise prices by capping annual increases across a basket of fares to the percentage change in RPI – the fare cap applying to a combined area containing some 45% of the population of Scotland[21]; and

(b) restrict reductions in levels of services and what First can do by way of competitive responses to entrants on routes where it operates.

5.5 The effect of the Undertakings are considered in Section 8 dealing with the assessment of the effects of the merger on competition.

Rail regulation

5.6 The restrictions on fares, revenues and aspects of service quality in the ScotRail franchise flow from general regulation on TOCs and restrictions that will be contained in the ScotRail franchise itself.

A - General

5.7 All TOCs are subject to regulation by the Rail Regulator and the SRA. The Rail Regulator is primarily responsible for granting licences, for setting conditions for those licences and for enforcement of them[22].

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[19] Paragraph 2.57
[20] NEG/ScotRail Railways (Cm 3773, December 1997), paragraph 2.79
[21] Source: OFT press release, FirstGroup plc/SBH, advice on post reference undertakings.
[22] The SRA is now responsible for the consumer aspects of licences.

5.8 The SRA's principal responsibilities include negotiating and awarding passenger rail franchises and monitoring the performance of the franchisees. The controls exercised by the SRA are contained in the franchise agreement:

- Train service levels - under current franchise agreements, TOCs have to deliver a level of service which fulfils the passenger service requirement (PSR) specified by the SRA. The developing franchise model (which will be used for ScotRail) strengthens the role of the SRA as a specifier of the services to be operated. The SRA is introducing a "Service Level Commitment" which replaces the existing PSR. The Service Level Commitment (SLC) will be specified by the SRA to the TOC on a timetable by timetable basis in such detail as the SRA decides. The SLC specifies the level, frequency, maximum journey times and stopping patterns of the service. The TOC will not be permitted to operate any service or make or remove any station call which is not in accordance with the SLC.[23]

- Fare controls - are currently being developed by the SRA but are expected to continue in a revised form, such that the fares regulation policy will impose caps on price increases for regulated fares.

5.9 The ScotRail franchise therefore will be more like a service delivery contract, with the SRA able to specify the service to be operated timetable by timetable. The franchisee will have no opportunity to develop or amend its services save with SRA consent (if less than the SLC) and it will be subject to the SRA's ongoing specification. Consequently rail is significantly constrained in its commercial freedom.

B - The ScotRail franchise

5.10 In relation to franchises which include the operation of services in the main conurbations (apart from London), the role of the SRA is in effect shared with the relevant Passenger Transport Executive. Within Scotland, SPTE has responsibility for rail services within the Strathclyde area[24].

5.11 In the case of the ScotRail franchise, as well as the SRA, both SPTE and the Scottish Executive are involved in the negotiation and award of, and will be parties to, the franchise agreement. First's current understanding of the level of control that the various stakeholders will have and therefore the extent to which it will be restricted is as follows:

Fares

5.12 The policy for fares for the ScotRail franchise is set out in the ITT. The SRA (in conjunction with the Scottish Ministers) will continue to set regulated fares for the ScotRail franchise. The regulated fares are standard class return saver fares and weekly season tickets. Where no saver ticket exists the standard day return fare is regulated.

5.13 Under the current franchise, SPTE sets the fares in the Strathclyde area and takes revenue risk. SPTE will retain the right to specify fares within this area, and is expected to do so. Therefore the franchisee will not have any control over the fares charged by ScotRail within the Strathclyde area.

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[23] A financial adjustment mechanism applies to neutralise the effects of changes to the SLC.

[24] The Strathclyde area consists of 12 council areas: Glasgow City; North Lanarkshire; South Lanarkshire; North Ayrshire; East Ayrshire; South Ayrshire; East Dunbartonshire; West Dunbartonshire; Renfrewshire; East Renfrewshire; Inverclyde; and Argyll and Bute.

5.14 Outside of the Strathclyde area in the 2002/2003 financial year, directly regulated fares accounted for ***[confidential information]*** of ScotRail's revenue. Whilst ScotRail will have some flexibility, it will in reality be constrained by the impact of the controls on regulated fares and the need to take account of the relationship between prices for regulated and unregulated ticket types. By electing key season ticket and leisure fares for direct regulation, the SRA are in effect influencing all other fares because of the need to retain a sensible commercial relationship between the level of regulated and other fares.

5.15 For the purpose of bidding, bidders have been required to assume fare increases of RPI +1% for all fares within the Strathclyde area and for regulated fares across the remainder of the franchise.

Revenue risk

5.16 ***[confidential information]***

5.17 ***[confidential information]***

(a) ***[confidential information]***

(b) ***[confidential information]***

5.18 ***[confidential information]***

5.19 ***[confidential information]***

Service levels

5.20 The minimum level of service provision is specified for ScotRail in the SLC, which is based on the current timetable. The SLC is specified by the SRA (SPTE in the Strathclyde area) and is implemented by the franchisee in accordance with an agreed procedure (controlled by the SRA/SPTE). Various other aspects of service quality are set out in the franchise agreement and are measured against Key Performance Indicators (now SQUIRE (Service Quality Incentive Regime)). ***[confidential information]***

5.21 ***[confidential information]***

Conclusion on rail regulation

5.22 As regards the rail services that ScotRail will provide, the service levels will be dictated by the SRA (SPTE in Strathclyde) in the franchise agreement (under the Service Level Commitment) and other service quality issues will be secured through a performance regime. ScotRail will therefore be committed to providing those levels of service and service quality. Any changes can only be made with the consent of the SRA (and/or SPTE). First would not be able to reduce the level of service or service quality without breaching the terms of the franchise agreement.

5.23 As SPTE sets the fares in the Strathclyde area ***[confidential information]*** the franchisee will not have any control over the fares within the Strathclyde area. The SRA (in conjunction with the Scottish Ministers) will continue to regulate regulated fares throughout the ScotRail franchise[25].

5.24 The situation in Strathclyde is therefore such that neither First or ScotRail is able to reduce the level of service provided on the SPTE supported services, or to raise fares on any SPTE services, without breaching the terms of the franchise agreement. To the extent that rail services are substitutable with First's bus services on the overlap routes, therefore, the competitive constraint which the rail services present cannot be relaxed by First unilaterally.

5.25 Outwith Strathclyde, whilst First has some discretion in relation to fares it will in reality be constrained by the impact of the controls on regulated fares and the need to take account of the relationship between prices for regulated and unregulated ticket types.

5.26 As the OFT concluded in its Decision, "…it is unlikely that the successful bidder will have significant latitude to raise prices or alter service levels on the railways."

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[25] The regulated fares are standard class return saver fares and weekly season tickets. Where no saver ticket exists the standard day return fare is regulated.

6 Competition to First – actual and potential

6.1 First's bus operations in central and south-east Scotland, but excluding Aberdeen, were considered by the then MMC in September 1996 when First's acquisition of SB Holdings Limited was referred. Since then significant changes have taken place in the bus markets within those areas resulting in a material increase in competition to First.

6.2 As a consequence the Competition Commission should not take the circumstances prevailing in the relevant bus markets at that time, and recorded in its Report in January 1997, as any indication of how competitive the market is today. In this Section we consider the level of actual and potential competition faced by First today.

6.3 We have, due to the specific characteristics peculiar to each and for the sake of convenience, considered competition separately in relation to the following areas:

(a) First Glasgow's operating area: Glasgow City, East and West Dunbartonshire, North and South Lanarkshire, East Renfrewshire and Renfrewshire;

(b) Greater Edinburgh and the Lothians (First Edinburgh); and

(c) Stirling, Falkirk and Clackmannanshire (First Edinburgh).

6.4 In particular, for First Edinburgh, Greater Edinburgh and the Lothians is more densely populated and urban in character than Stirling, Falkirk and Clackmannanshire. In Greater Edinburgh and the Lothians, First is not the majority operator – that is Lothian Buses.

Level of competition faced by First on commercial services

6.5 In the OFT's advice to the Secretary of State recommending acceptance of the Undertakings (outlined in Appendix 6), the OFT sought consent to review the fare cap undertaking, which it has agreed to do. First is firmly of the view that competition in the bus markets covered by the Undertakings, in Glasgow, central Scotland and the Lothians, has increased to such a level that there are sufficient competitive constraints on First, and the Undertakings are no longer required. We have noted in Appendix 8 the main changes that have taken place in the relevant bus markets since January 1997.

6.6 The evidence submitted to the OFT in connection with a review of the Undertakings referred to an analysis carried out by First of the level of competition on First's services. The analysis looked at the on-bus revenue generated by its commercial services on which it faced competition. The analysis used figures as at February 2003. First does not believe the situation would have changed materially save for the fact that competition has increased in Glasgow and therefore the impact of competition may be understated.

6.7 This analysis showed that ***[confidential information]*** of First Glasgow's on-bus revenue comes from services where it faces competition by another operator over some part of its route and ***[confidential information]*** of revenue comes from services where it faces competition on at least half the route. This illustrates that First Glasgow faces effective competition in Glasgow as, if First Glasgow were not facing effective competition then one would expect to see a large number of routes where First Glasgow did not face competition and on which First Glasgow generated high revenues.

6.8 The analysis of competition on First Edinburgh's services considered East Lothian, West Lothian and Midlothian. The City of Edinburgh was not included as it does not fall under the scope of the Undertakings. The analysis demonstrated that First faced some level of competition in East Lothian and Midlothian on services representing ***[confidential information]*** of all estimated on-bus revenue on commercial or partly tendered services. The figure was over ***[confidential information]*** in West Lothian.

6.9 The revenue generated by those services on which First faces some level of competition in Stirling, Falkirk and Clackmannanshire represents approximately ***[confidential information]*** of all on-bus revenue generated by commercial and partly tendered services.

6.10 As the above figures indicate, First faces significant levels of competition. Competition comes from both major bus operators and also from a large number of smaller independent operators.

6.11 Smaller independent operators are able to exert a significant competitive presence in local markets and compete with the larger operators, despite their size. Barriers to entry and expansion are low, especially for entry on a small scale. The task facing the major operators of influencing passenger choice of service is not insignificant. As the MMC have put it[26], ".. passengers will generally board the first bus for their destination which comes and will not be prepared to wait long for a later bus which may be more comfortable or may even charge lower fares (unless the difference is large). It is therefore possible for small, under-capitalised operators with old buses to abstract revenue on a significant scale from incumbents offering a more comprehensive and reliable service using modern vehicles".

A. First Glasgow's operating area

6.12 Within its operating area, First Glasgow faces significant competition from other public transport operators, principally bus, coach and the underground.

Actual competitors - Bus

6.13 In 1996, the MMC (in the FirstBus/S B Holdings inquiry) estimated First's share of the Glasgow market as 89%. First Glasgow estimates that the current market shares (based on PVR) for commercial services within First Glasgow's operating area are as follows:

	%
First Glasgow	***[confidential information]***
Arriva	***[confidential information]***
McKindless	***[confidential information]***
Stagecoach	***[confidential information]***
Others	***[confidential information]***

6.14 Whilst the areas are not directly comparable, First's share at around ***[confidential information]*** still indicates it is a very material reduction of its market share and is due to the significant increase in competition from other bus operators. The competition comes from the larger bus operators, such as Arriva and Stagecoach (which has remained in the market since its original entry in 1997) but also from a large number of independent operators which have either entered the market or increased in size since 1996.

6.15 Within First Glasgow's operating area it faces competition from approximately 150 other bus operators. First Glasgow's main competitors are listed in the table attached at

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[26] MMC Report on the Supply of Bus Services in the North East of England (Cm 2933, August 1995).

Appendix 9 which also gives the location of their depots and fleet size. Of the competitors listed, ***[confidential information]***. In 1996, SBH had a fleet of approximately 1250 vehicles and, it estimated, its competitors at that time had a fleet of approximately 1180 vehicles. Those operators listed together operate a fleet today of approximately ***[confidential information]*** vehicles, compared to First Glasgow's fleet of ***[confidential information]*** vehicles, a significant turnaround.

Arriva

6.16 Arriva operates in Glasgow through its subsidiary Arriva Scotland West. Arriva is one of the UK's largest bus operators, with a group turnover of £2,084 million for the year ended 31 December 2002 (to which its UK bus division contributed £559.8 million). It operates over 6,000 vehicles in the UK.[27]

6.17 Arriva Scotland West's operating area covers the area west of Glasgow and south of the river Clyde down to the Largs area. Closer to Glasgow, Arriva primarily operates inter-urban services between locations in Renfrewshire and East Renfrewshire and Glasgow city centre along with many local services operating within Renfrewshire and East Renfrewshire. First Glasgow estimates that Arriva operates approximately ***[confidential information]*** vehicles from its two depots in Renfrew and Paisley.

6.18 Arriva currently competes against First Glasgow along the Paisley Road West corridor between Paisley and the city centre, which overlaps with ScotRail's services between Paisley Gilmour Street and the city centre and Paisley Canal and the city centre. Arriva competes against First Glasgow in terms of frequency and price. For example, between Paisley Gilmour Street and the city centre Arriva operates services at a frequency of 8 buses per hour, matching that of First Glasgow. In terms of price, Arriva matches First Glasgow's single and return fares but tends to be cheaper than First Glasgow on day and season tickets. For example, Arriva charges £1.75 for the equivalent of First Glasgow's off peak First Day ticket which is priced at £2.20. Arriva also competes against First Glasgow on the Pollokshaws Road, Govan Road and Dumbarton Road corridors.

Stagecoach

6.19 Stagecoach competes against First Glasgow through its subsidiaries Stagecoach Glasgow, Stagecoach Fife and Stagecoach Western. Stagecoach is one of the UK's largest bus operators, with a market share of approximately 16% of the UK bus market. Stagecoach had a group turnover of £2076.6 million for the year ended 30 April 2003, to which its UK bus division contributed £598.4 million. It operates approximately 7,100 vehicles in the UK[28].

6.20 Stagecoach Fife primarily operates within Fife itself but has a number of inter-urban services that extend to Glasgow. Stagecoach Western operates services in the south west of Scotland, including Dumfries, Ayr, Stranraer and Kilmarnock and has a fleet of approximately ***[confidential information]*** vehicles. Stagecoach Glasgow was launched in direct competition to First Glasgow and entered the market in Glasgow in 1997 (see Appendix 8). As a result, Stagecoach continues to be a significant presence in terms of both actual and potential competition in the market. First Glasgow estimates that Stagecoach currently operates approximately ***[confidential information]*** vehicles from its depots in Kilmarnock and Blochairn.

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[27] Source: Arriva plc's Annual Report and Accounts.
[28] Source: Stagecoach Group plc, Annual Report and Accounts 2003.

6.21 Stagecoach currently operates 5 routes in Glasgow, operating at a PVR of approximately 35. Stagecoach operates 3 services at a frequency of every 10 minutes or less within Glasgow itself as well as inter-urban services between the city centre and Cumbernauld and the city centre and Ayr/Kilmarnock.

6.22 Stagecoach competes on both frequency and fares. For example, on the Gallowgate corridor between Bailleston and Glasgow city centre, First currently operates services at a combined frequency of 14 buses per hour. In May 2002, Stagecoach introduced service 162 along the entire length of the corridor at a frequency of 8 buses per hour. On this service Stagecoach currently charges fares of 55p for a "short hop" and 90p main adult single fare, which is cheaper than each of First Glasgow’s equivalent fares on the corridor. Stagecoach also offers a weekly ticket priced at £5 for journeys along the corridor, which is significantly lower than the cheapest comparable weekly fare offered by First of £7.20.

McKindless

6.23 As well as Stagecoach and Arriva, First Glasgow also faces significant competition from McKindless, an independent operator. McKindless currently operates a network of local bus services within North and South Lanarkshire as well as frequent services between the city centre and Hamilton and Kirkintilloch. McKindless also provides services within Glasgow itself. McKindless currently operates approximately ***[confidential information]*** vehicles from its two depots in Wishaw and Rutherglen.

6.24 McKindless is one of several independent operators that have experienced significant growth over the past few years. Since 1996, McKindless' fleet has increased in size from ***[confidential information]*** vehicles to ***[confidential information].*** On 22 January 2002, McKindless opened a second depot at Rutherglen on the outskirts of the city to service two school tenders that it had been awarded the previous year. In the intervening period, McKindless has expanded the number of services operated out of the depot to include commercial services operated in the city centre and out to Kirkintilloch and Hamilton.

6.25 As with Stagecoach and Arriva, McKindless seeks to compete on both frequency and price.

Independent operators

6.26 The Glasgow market has also seen a sustained increase in the size and strength of pre-existing independent operators (such as McKindless) which have both assisted and benefited from an increase in passenger numbers within the market. This is best demonstrated by analysing the respective fleet sizes of some of those independent operators currently and the size of their fleets in 1996 at the time First acquired S B Holdings. In the table attached at Appendix 9 we show how independent operator's fleet sizes have increased since 1996.

6.27 In addition to the expansion of pre-existing operators, there has also been significant new entry by independent operators since 1996. The following operators listed in Appendix 9 have entered the market since 1996:

Operator	**Fleet size**
[confidential information]	***[confidential information]***
[confidential information]	***[confidential information]***
[confidential information]	***[confidential information]***
[confidential information]	***[confidential information]***
[confidential information]	***[confidential information]***
[confidential information]	***[confidential information]***

[confidential information]	***[confidential information]***
[confidential information]	***[confidential information]***

6.28 First faces material levels of competition from the following independent operators:

Avondale – is based at Greenock[29] and has a fleet of ***[confidential information]*** vehicles. It operates primarily commercial services, including services between Faifley and Glasgow city centre at a frequency of 6 buses per hour, which when combined with the services of other independent operators[30] on the corridor gives a combined frequency of 17 buses per hour and overlaps on the overlap route, Clydebank and Partick. Along the same corridor First Glasgow operates services at a frequency of 10 buses per hour between Clydebank and Partick.

Caledonia – is based in Castlemilk and currently operates a fleet of [***[confidential information]*** vehicles operating commercial services. As mentioned above, Caledonia is one of a number of new entrants into the bus market, entering in October 2001. Caledonia operates services on the Victoria Road corridor between Battlefield and Glasgow City Centre, at a combined frequency of 10 buses per hour. The services also operate on the overlap route, Queens Park and Glasgow. In terms of fares, Caledonia's fares have remained consistently cheaper than those of First Glasgow.

S & A Coaches (***City Sprinter)*** – is based in Renfrew and operates ***[confidential information]*** vehicles providing a commercial service between Eastwood Toll and Glasgow city centre. This service competes with First Glasgow's services along the corridor, as well as those of Stagecoach and McKindless. The service also operates over the overlap route between Giffnock and Glasgow.

Canavan **–** is based in Kilsyth and has a fleet of ***[confidential information]*** vehicles, operating both commercial and tendered services in North Lanarkshire and Glasgow. Canavan competes on a number of its services against those of First Glasgow, including its services between Garthamlock and Glasgow city centre. The service also operates over the overlap route between Alexandra Parade and Glasgow.

Central Bus Co – is based in Motherwell and operates a fleet of approximately ***[confidential information]*** vehicles in the provision of both commercial and subsidised services in North and South Lanarkshire. Central competes against First Glasgow on commercial services within North and South Lanarkshire.

Dickson – is based in Erskine and has a fleet currently of approximately ***[confidential information]*** vehicles providing commercial services along the Paisley Road West corridor. Along this corridor Dickson currently operates a high frequency service of 10 buses per hour, which competes with the services of both First Glasgow and Arriva, which both operate at frequencies of 8 buses per hour. The services also operate over the overlap route between Paisley Gilmour Street/Paisley Canal and Glasgow.

McColls – is based in Balloch and has a fleet of approximately ***[confidential information]*** vehicles operating both tendered and commercial services in West Dunbarton and the western part of Glasgow. McColls has recently introduced a new commercial service operating between Helensburgh, Dumbarton and Clydebank which, when combined with the services of other independent operators along the same corridor matches the frequency of First Glasgow along that section at 6 buses/hour.

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[29] Avondale also has an outstation at Clydebank.
[30] The other operators are DB Travel (5 per hour) and Beta Buses (6 per hour).

Potential competitors - Bus

6.29 Potential competition is as effective a constraint in local bus markets as actual competition. The barriers to entry and expansion in First Glasgow's operating area and Strathclyde generally are low. The location of depots is usually regarded as important for the threat of potential competition. It is commonly thought in the bus industry that the maximum range of bus services from its depot is 15 to 20 miles in rural areas and 5 to 10 miles in urban areas, apart from infrequent inter-urban services. All the operators who currently provide actual competition in First Glasgow's operating area are well placed given the location of their depots to increase the level of their operations.

Other modes

Coach

6.30 Citylink is Scotland's leading provider of express coach services. Citylink's turnover for the year ended 31 December 2002 was £12.2 million. Citylink is part of the ComfortDelGro Group (based in Singapore) which is one of the five largest profit listed passenger and transport companies in the world. Each year over 3 million passengers travel with Scottish Citylink to more than 200 destinations. Citylink provides 400 express coach services per day. Citylink's operations principally comprise, amongst other things, shuttle services across central Scotland, including the high frequency service (4 coaches per hour at peak times) on its flagship route between Glasgow and Edinburgh.

6.31 The services of First Glasgow and Citylink compete between Cumbernauld and Glasgow. Citylink's service is a non-stop express service and therefore quicker than those of First Glasgow. Citylink also competes with the services of First between Dunblane and Stirling and Stirling and Glasgow (which are overlap flows) and has recently revised its service to increase its coverage to include the flows: Bridge of Allan – Stirling and Dunblane – Bridge of Allan.

Underground

6.32 The underground network in Glasgow consists of a 6 ½ mile loop (known as the Clockwork Orange) on which there are 15 stations. In the year ended 31 March 2003 the Underground generated revenue of £10.7 million and had 13.4 million passenger journeys[31]. The Underground competes with the services of First Glasgow and ScotRail between Partick and Glasgow and operates at a frequency of between 10 and 15 trains per hour.

B. First Edinburgh – Greater Edinburgh and the Lothians (GEL)

6.33 In the GEL, First Edinburgh currently operates a fleet of approximately ***[confidential information]*** vehicles primarily operating from depots at Dalkeith, Musselburgh, Linlithgow, Livingston and Galashiels as well as the outstation at North Berwick. Since October 2001 the number of vehicles operated by First in the GEL has reduced by almost a quarter due to the closure of a depot by First at Westfield in the City of Edinburgh and the reduction of service levels in Greater Edinburgh following intense competition from Lothian Buses.

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[31] Source: Scottish Transport Statistics No 22 – 2003 Edition.

6.34 The nature of local bus services in GEL is primarily urban/city services based in Edinburgh and the towns in the Lothians, and inter-urban services into and out of Edinburgh. Within GEL, First Edinburgh faces competition from large operators, such as Lothian Buses and Stagecoach, as well as a number of smaller independent operators.

Actual competitors - Bus

6.35 First Edinburgh estimates that the current market shares (based on PVR) for commercial services in GEL are as follows:

	%[32]
Lothian Buses	***[confidential information]***
First Edinburgh	***[confidential information]***
Stagecoach	***[confidential information]***
Horsburgh	***[confidential information]***
Others	***[confidential information]***

6.36 We attach at Appendix 9 a list of bus operators who compete (whether actually or potentially) with First in the GEL, their depot locations and fleet size.

Lothian Buses

6.37 Lothian Buses is owned by the following authorities: City of Edinburgh, West Lothian, East Lothian and Midlothian. It is the major operator in GEL providing local bus services in the City of Edinburgh and in parts of the Lothians. Lothian Buses operates mostly urban/city services in and around the City of Edinburgh, with some inter-urban services following aggressive expansion in recent years into East Lothian and Midlothian, which has increased its network coverage and its market share.

6.38 For the year ended 31 December 2002, Lothian Buses had a turnover of £62.9 million, which is more than ***[confidential information]*** First Edinburgh's turnover for its entire operations. Lothian Buses' fleet in GEL is nearly ***[confidential information]*** times the size of that of First Edinburgh in the same area and is an increase of approximately 11% on the previous year. First Edinburgh estimates that Lothian Buses has a fleet of ***[confidential information]*** vehicles which it operates from its three depots in the City of Edinburgh.

6.39 The majority of the competition faced by First Edinburgh from Lothian is on frequency and fares, and occurs on many of those routes where First Edinburgh's services overlap with those of ScotRail. For example, on the Balerno to Wallyford corridor which, runs through the City of Edinburgh from the western edge of the city into East Lothian, and overlaps with ScotRail's services between Curriehill and Edinburgh and Wallyford and Haymarket, First Edinburgh operates along the corridor at a combined frequency of approximately 6 buses per hour. Lothian Buses competes along the entire length of the corridor matching the frequency of First Edinburgh and has also introduced a maximum adult single fare of £1. First has responded by reducing its fares to match Lothian's. Over the majority of the route, Lothian Buses' frequency is further enhanced by additional services so that between Slateford and Haymarket, Lothian Buses' combined

[32] Adds to 101 due to rounding.

frequency increases to 21 buses per hour and between the city centre and Musselburgh to 16 buses per hour.

6.40 Lothian Buses also has a past record of extending its operations beyond its current operating area. As recently as August 2001, Lothian Buses extended its services to Haddington, with adult single fares of £1.00 (Haddington – Princes Street), far cheaper than First Edinburgh's equivalent fare of £2.25. In addition, Lothian has also previously operated services to South Queensferry, Armadale, Bathgate and Livingston.

Stagecoach

6.41 Since 2001, Stagecoach's market share in GEL has increased. Stagecoach Scotland East's operations are contiguous with the north and east of First Edinburgh's overall operating area. Stagecoach's operations primarily consist of services within the Fife, Grampian and Highland regions with inter-urban services extending to Edinburgh, Dundee, Glasgow, Inverness and Perth. As at December 2002, First Edinburgh estimates that Stagecoach Scotland East operates a fleet of ***[confidential information]*** vehicles from a depot in Perth and 6 depots in Fife. Its nearest depot to Edinburgh is at Dunfermline which has a fleet of 62 vehicles and is less than 20 miles from Edinburgh city centre.

6.42 Within GEL, Stagecoach competes with First Edinburgh on services on the Queensferry Road into Edinburgh city centre. Whereas First Edinburgh has a frequency of 3 buses per hour (off-peak) along the corridor, Stagecoach has a frequency of 12 buses per hour (off peak).[33]

Independent operators

6.43 First Edinburgh's recent experience shows that independent operators have successfully focused on the more popular parts of First Edinburgh's network. This is particularly the case in West Lothian where First Edinburgh has over the past three years faced particularly vigorous competition from Horsburgh, and others:

Horsburgh – is based in Livingston and over the past three years has increased in size from ***[confidential information]*** to ***[confidential information]*** vehicles. It operates mainly in West Lothian, and primarily operates commercial urban and inter urban services as well as some tendered services. The extent of the competition posed by Horsburgh is clear when the size of Horsburgh's fleet is compared to the ***[confidential information]*** vehicles that are currently based at First Edinburgh's depot at Livingston. Horsburgh's commercial services include long routes from Armadale to Livingston via Bathgate and from Livingston to Linlithgow via Broxburn which compete with key parts of First Edinburgh's commercial network in West Lothian. Where Horsburgh competes with First Edinburgh, Horsburgh seeks to charge lower fares.

Davidson – is based in Livingston and currently operates ***[confidential information]*** vehicles primarily in West Lothian. Davidson operates both commercial and tendered services and competes against First Edinburgh on services between Fauldhouse, Whitburn and Bathgate.

Bulldog – is based in Bathgate and currently operates ***[confidential information]*** vehicles in West Lothian. Bulldog primarily operates commercial services (both urban

[33] Including limited stop services and its yellow taxi-bus service.

and inter-urban) in and around Livingston and Bathgate. Bulldog also competes with First Edinburgh on its commercial services in Livingston itself.

HAD – is based in Shotts and operates a fleet of ***[confidential information]*** vehicles in West Lothian as well as in and around Glasgow and has recently introduced the X71 service competing on a number of flows where First overlaps with ScotRail.

Ross Prentice – is based in Haddington and currently operates ***[confidential information]*** vehicles in GEL on commercial and tendered services. It currently provides commuter journeys which compete against First Edinburgh's services between Haddington and Edinburgh.

Prentice Westwood – is based in West Calder and has a fleet of ***[confidential information]*** vehicles operating mainly tendered school services in West Lothian. In the past, it has also provided commuter services between West Lothian and Edinburgh in competition with First Edinburgh.

SD Travel – is based in Whitburn and currently operates a fleet of ***[confidential information]*** vehicles in West Lothian, including commercial services which compete with First Edinburgh.

Potential competitors - Bus

6.44 All the operators who actually compete with First in GEL are well placed to expand to increase the level of competition. This is particularly true of the following operators:

Lothian Buses **-** with a significantly larger turnover and fleet, Lothian has the resources and ability to increase its operations as it has successfully done so over the past few years. In particular, Lothian Buses has a past record of operating services between both South Queensferry and Livingston and Edinburgh and is therefore capable of doing so again. More recently, Lothian Buses operated services to Haddington in East Lothian. Lothian Buses also currently operates services to Balerno. First Edinburgh therefore considers that Lothian Buses would be capable of operating services beyond Prestonpans further into East Lothian and beyond Balerno into West Lothian, providing further competition.

Stagecoach – also has the ability and resources to expand its operations further should the opportunity arise. Its depot at Dunfermline is less than 20 miles from Edinburgh city centre. It would be relatively straightforward for Stagecoach to reroute its services which operate along Queensferry Road into South Queensferry and on to Edinburgh.

Horsburgh **-** the successful expansion of its fleet and operations over the past three years has demonstrated that Horsburgh is not intimidated by First Edinburgh's presence. Horsburgh has a significant presence in West Lothian. Its depot is less than 4 miles from First's Livingston depot. This means that it is well placed to compete against services between Livingston/West Calder and Edinburgh as well as between Polmont and Edinburgh.

HAD - since 1996, HAD has successfully increased its fleet from ***[confidential information]*** vehicles to ***[confidential information]***. Its depot is less than 15 miles from First's depot in Livingston and due to the recent loss of a number of tenders HAD currently has surplus vehicles available, which it has recently used to operate a new commercial service (the X71).

Prentice Westwood – is only based 8 miles from First Edinburgh's depot in Livingston. Given Prentice Westwood's size, its location and its past history, it provides significant potential competition particularly in relation to services between West Calder and Edinburgh.

6.45 There are several operators who are not at present competing in the City of Edinburgh or East or West Lothian but who could do so and therefore are potential competitors. In particular:

MacEwans - is based in Dumfries and currently has a fleet of ***[confidential information]*** vehicles. MacEwans currently operates only tendered services in Midlothian and the Borders. Over the past few years MacEwans has shown a willingness to operate such services at a considerable distance from its depot. Whilst MacEwans does not currently operate any commercial services in this area, it has done so in the recent past.

Munros - is based in Jedburgh and has a fleet of ***[confidential information]*** vehicles. Since 1997, Munros has developed from operating primarily coach hire and school tenders in the Scottish Borders into an operator of commercial services and local service tenders, extending its operating area into Midlothian and the City of Edinburgh. Over the same period Munros has increased its fleet size from ***[confidential information]*** vehicles to ***[confidential information].***

C. First Edinburgh – Stirling, Falkirk and Clackmannanshire (SFC)

6.46 In SFC, First Edinburgh currently operates a fleet of approximately ***[confidential information]*** vehicles from its depots at Bannockburn, Balfron, Larbert and Linlithgow.[34] In contrast to GEL, and due to the more rural nature of the area and in some cases more sparse population the provision of local bus services in SFC is based mainly on inter-urban and rural services, with urban services in Falkirk and Stirling. This is reflected in the nature of services operated by First, of which over ***[confidential information]*** are wholly or partly tendered within the three unitary authority areas as a whole. Within Falkirk and Clackmannanshire this figure rises to ***[confidential information].***

Actual competitors - Bus

6.47 First Edinburgh estimates that the current market shares (based on PVR) for commercial services in the SFC area are as follows:

	%
First Edinburgh	***[confidential information]***
Mackie	***[confidential information]***
Stagecoach	***[confidential information]***
Ferguson	***[confidential information]***
Goosecroft	***[confidential information]***
Mitchell	***[confidential information]***
Hunter	***[confidential information]***
Morrison	***[confidential information]***

[34] Linlithgow is in West Lothian but a substantial part of the depot's operations are in SFC.

6.48 We attach at Appendix 9 a list of bus operators who compete (whether actually or potentially) with First in the SFC area, the locations of their depots and fleet size.

6.49 The competition faced by First in SFC comes primarily from independent operators, although Stagecoach also currently operates both commercial and tendered services in Stirling and Falkirk. First Edinburgh also faces competition on services between Dunblane, Stirling and Edinburgh from Scottish Citylink, a substantial coach operator.

6.50 The majority of the independent operators have been in existence for some time but have expanded their operations over the past few years. Whilst these operators originally concentrated on the provision of coach hire services and some school tenders, several such as Goosecroft, Mitchell, Ferguson, Morrison and Hunter have expanded the scope of their operations to include non-school tenders and commercial services.

6.51 First Edinburgh faces competition from the following operators in particular, mostly in and around Clackmannanshire and Stirling:

Scottish Citylink – recently Citylink took over the operation of service M9[35] between the University of Stirling, Stirling and Edinburgh, which Citylink has altered to serve Dunblane rather than the University. Therefore, Citylink provides a competing service to that of First Edinburgh between Dunblane and Stirling and between Stirling and Edinburgh, and has recently revised its service to increase its coverage to include the flows: Bridge of Allan – Stirling and Dunblane – Bridge of Allan.

Stagecoach – has significant contiguous operations to those of First Edinburgh in SFC. Its closest depot to the SFC is Dunfermline which is approximately 20 miles from both Bannockburn and Larbert. Currently Stagecoach operates both tendered and commercial services in the SFC, primarily in and around Stirling and through the SFC to destinations outside of the area.

Goosecroft – is based in Denny, which is less than 7 miles from both of First Edinburgh's depots in Bannockburn and Larbert. Goosecroft currently operates ***[confidential information]*** vehicles on commercial services in and around both Stirling and Falkirk. Goosecroft also operates a tendered service in Balfron.

Mackie – is based in Alloa, less than 15 miles from Larbert and 10 miles from Bannockburn. Mackie currently operates ***[confidential information]*** vehicles, including commercial bus services between Stirling and Clackmannanshire and within Clackmannanshire, all of which compete with First Edinburgh.

Hunter – is based in Sauchie, near Alloa and currently operates ***[confidential information]*** vehicles on commercial and tendered services in and around Stirling. Hunter entered the commercial service market this year, having previously concentrated mainly on the provision of private hire and school contracts.

Ferguson – is based in Stirling less than 5 miles from First Edinburgh's depot at Bannockburn and 15 miles from the depot at Larbert. Ferguson operates a recently increased fleet of ***[confidential information]*** vehicles on commercial services in and around Stirling. Ferguson primarily competes with First Edinburgh on its services between Stirling city centre and the University, on which competition has recently increased (see below).

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[35] Previously operated by First.

Mitchell – is based in Plean approximately 6 miles from Larbert and 4 miles from Bannockburn. It operates a fleet of ***[confidential information]*** vehicles on a mixture of coach and local bus services (both commercial and tendered) in and around Stirling. Mitchell has recently invested in new vehicles, including a low floor bus, to provide local bus services.

6.52 First Edinburgh's recent experience has shown that in spite of their smaller size, operators such as Hunter, Mackie and Ferguson are not intimidated by First Edinburgh. An example of the type of competition currently provided by these operators is on the corridor between Stirling city centre and Stirling University. First Edinburgh operates services at a combined frequency of 12 buses per hour along the corridor. Ferguson operates services at a combined frequency of at least 6 buses per hour, having doubled its frequency over the past year. Ferguson also competes very actively against First Edinburgh on fares. For example, Ferguson's adult single fare of 75p is cheaper than that of First Edinburgh of £1.10 for the same distance. First Edinburgh has since introduced a 75p students' fare to match Ferguson.

6.53 Further competition is also provided by both Morrison and Hunter. Morrison introduced commercial services in the evenings in March 2003 following the loss of a tender. Hunter also entered the market in May 2003 providing a service between the campus and the centre of Stirling at a frequency of 1 bus per hour. There is also further competition along the corridor from Mackie which currently operates a commercial service of 1 bus per hour to the University. This is further supplemented by an infrequent commercial service to the University provided by Stagecoach. There are also a number of tendered services with a combined frequency of approximately 2 buses per hour which are operated by a number of operators, including Stagecoach.

Potential competitors - Bus

6.54 Those operators who compete with First in SFC are well placed to expand their operations, and therefore the level of competition in the area. This is particularly true of the following:

Stagecoach – has both the ability and the resource to increase its current level of operations in SFC. Stagecoach recently bid for and won a short term contract for the operation of 15 double deck buses in Stirling in June 2003. Its depot at Dunfermline is within operating distance of both Stirling and Falkirk.

Hunter – the recent expansion by Hunter of its operations into commercial services and its willingness to compete against First Edinburgh also means that it provides significant potential competition. This is particularly the case in and between Stirling and Falkirk as its base in Sauchie means that they are both within its potential operating area.

Horsburgh – has over the past two years commenced operating tendered school services in and around Falkirk. As Horsburgh's depot is less than 10 miles from Linlithgow and with its recent expansion to ***[confidential information]*** vehicles and its history of competition with First Edinburgh in West Lothian, First Edinburgh views Horsburgh as having the potential to increase competition particularly between Falkirk, Linlithgow and Edinburgh.

Mackie – has, in August 2002, commenced operating a school contract between Tyndrum and Callander which had, until then, been operated by First Edinburgh and is outside the area within which Mackie has traditionally operated. Like Hunter, Mackie's base in Alloa means that it is capable of increasing the level of its operations, particularly in both Stirling and Falkirk.

Mitchell – due to its location and the proximity of both Stirling and Falkirk, Mitchell is also a potential competitor in that area.

6.55 In addition to those mentioned above there are also other independent operators based in Alloa, Plean and Stirling such as M-Line, Myles and Morrison who also currently compete against First Edinburgh and have the potential to increase their operations in and around Stirling and Falkirk. This is particularly the case with M-Line who has a fleet of ***[confidential information]***vehicles, providing mainly tendered services and who, First Edinburgh understands, has capacity as its tendered services are entirely school operations and therefore available for use during much of the day.

7 Barriers to entry and expansion

Rail

7.1 First do not disagree with the OFT's view expressed in the OFT's Decision, that barriers to entry into the passenger rail services market are high.

Bus

7.2 Barriers to entry and expansion into the bus market are low. This has been found to be the case in many previous decisions by the competition authorities the latest being Arriva plc/Lutonian[36]. It was acknowledged[37] that barriers to entry on a small-scale are not significant as the regulatory aspects are not onerous; staff can fairly easily be recruited; buses do not cost very much, particularly on the second hand market; maintenance can be economically contracted out; and storage may not be needed, only a parking space. First considers that in the geographic markets relevant to the reference barriers to entry and expansion are low. More explanation is given in the responses to the Economic Questionnaire.

7.3 The OFT identified in its Decision that previous bus investigations have pointed to the importance of the locations of depots in facilitating entry, which may be leased. Buses themselves may be bought outright or leased, and second-hand ones can be bought relatively cheaply. First agrees with the conclusions reached by the OFT in the OFT Decision that, "An existing operator with a local depot is unlikely to face significant barriers to expansion …".

7.4 The OFT did not identify any strategic barriers to entry in its decision to refer, rather it said that it was relatively easy to set up a bus depot and commence operations. The willingness of operators to enter affected routes was unclear to the OFT and it reached no decision on that other than to say that firms may be reluctant to do so if they fear predation. First does not consider that there is any evidence to suggest that competitors fear predation from First for the reasons set out below.

First do not have a reputation for predation

7.5 In the FirstBus/SB Holdings Report, the MMC considered whether First had such a reputation and stated[38]: "We have in the present inquiry received no complaints from other bus operators, small or large, attributing such behaviour to FirstBus or SBH."

First already faces significant levels of competition from other bus operators

7.6 First do not consider it is plausible that operators would not enter if First were to withdraw routes or reduce quality of service. First currently faces significant levels of actual competition from other bus operators, both large and small as explained in Section 6. These are operators who have already made the necessary capital investment and would be in a position to challenge on a route. Certainly the likes of Stagecoach, Lothian Buses and Arriva are well able to compete against First. In addition the number of smaller operators that are currently competing against First show that they are not intimidated by First. If such operators are competing against First as at today then there is no credibility in the argument that they would not compete in the future. There are

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[36] Arriva plc and Lutonian Buses Limited, Cm 4074, 1998
[37] Paragraph 4.58
[38] Paragraph 4.49

for example, few routes on which First Glasgow faces no competition at all from other bus operators.

7.7 In addition we also attach, at Appendix 7, lists showing which operators are currently competing with First on those flows where First overlaps with ScotRail. Again, if operators are currently competing against First over an overlap bus/rail flow then it is not credible to suggest that those operators would not extend their services if First were to say, withdraw.

Recent entry and expansion

7.8 Further evidence that operators both large and small are not intimidated by First, and therefore clear evidence that they do not fear predation by First is in the new entry recently faced by First. We have already referred in Section 6 to those existing competitors who have expanded competition with First, the levels of which are significant[39]. In addition we give brief details below of those operators who have recently entered the bus market or started operating commercial services against First. First's size clearly has not put these operators off competing with them, an indication it would not deter them in the future.

7.9 In Glasgow examples would be:

New Entrant	Date of entry	Explanation of entry and current status
Caledonia	March 2003	Entered the market by operating commercial services in competition with First. They started with ***[confidential information]*** vehicles and now operate a fleet of ***[confidential information[40]]*** having expanded their operations in April and October 2003, again competing against First.
Boyce	September 2003	Started operating commercial services in competition with First, having previously operated SPT school contracts. They currently operate ***[confidential information]*** vehicles.
PJ Travel	September 2003	Started operating commercial services in competition with First, having previously operated SPT school contracts. They currently have a fleet of ***[confidential information]*** vehicles.

7.10 In the Greater Edinburgh and Lothian area, HAD, an established operator of tendered services, commenced operating commercial services as recently as December 2003 (X71: Airdrie/Glasgow – Shotts – Livingston – Edinburgh), competing on a route already served by First through West Lothian. HAD's X71 service competes on a number of the flows where First overlaps with ScotRail (see Appendix 7). HAD has a fleet of ***[confidential information]*** vehicles.

[39] See also the response to Questions 33 and 34 of the Economic Questionnaire
[40] ***[confidential information]***

7.11 In the Stirling, Falkirk and Clackmannanshire area examples would be:

New Entrant	Date of entry	Explanation of entry and current status
Morrison	March 2003	Started operating a commercial service (evening only) between Stirling and the University in competition with a tendered service run by First.
Hunter	May 2003	Started operating a commercial service between Stirling – University – Alva – Tillicoultry whereas it had previously concentrated on contracts and private hire. They compete against First, Ferguson and Mackie, with a fleet of ***[confidential information]*** buses.

7.12 First did nothing in response to the above entries, and therefore have done nothing to suggest it would predate in the future.

First and compliance

7.13 ***[confidential information]***

- ***[confidential information]***
- ***[confidential information]***

The Undertakings

7.14 As already explained in Section 5, First has given anti-predation undertakings in relation to the "Midland Bluebird and Lowland operating area". Significantly, the OFT did not require anti-predation undertakings in Glasgow and therefore, First concludes, were not concerned that First was sufficiently dominant to deter entry to the Glasgow market.

7.15 First is therefore the subject of behavioural undertakings specifically designed to restrict its ability to predate within the unitary authority areas of Stirling, Clackmannanshire, Falkirk, West Lothian, Midlothian, East Lothian and the Scottish Borders. First is also under an obligation to ensure that all bus services that overlap with a competitor's must be evenly spaced between the competitors' bus services.

Rail

7.16 First's acquisition of a rail franchise will not have any impact on the conditions for competition in the bus industry or any impact on barriers to entry in the bus market.

8 Assessment of the effects of the merger on competition

8.1 Details of the overlap flows are given in Appendix 7. Whilst the lists of overlap flows show that there are nearly 800 point to point flows on rail routes where a bus travels between the same points, First does not consider that an analysis of these flows shows any meaningful level of competition between bus and rail on the vast majority of those flows, rather that they serve complementary functions (consistent with the previous findings of the competition authorities referred to in Section 3).

Hypothetical strategy that First would divert passengers from bus to rail

8.2 In this Section we consider the theory of competitive harm put forward by the OFT and identify the constraints that would prevent First from pursuing such a hypothetical strategy. In addition, First has no incentive to engage in a strategy of inducing passengers to switch from bus to rail as such a strategy will not lead to higher overall revenues, for a number of reasons.

8.3 Where appropriate we discuss conditions under which the presence of the constraint is sufficient to meet concerns, and so can be used to exclude flows from further analysis.

8.4 The OFT put to First in the course of its consideration of the merger that some competitors expressed concern that First could alter bus prices or reduce service frequencies to induce passengers to switch to overlapping rail services to increase overall revenue.

Rail and bus are in different product markets

8.5 In the OFT's Decision it stated, "Third parties generally considered that on point-to-point routes where bus and rail services overlapped, passengers would consider them to be substitutable for each other". The previous findings of the competition authorities (and indeed the OFT's own conclusions set out in its Decision – see paragraph 8.9 below) dismiss that contention.

8.6 The passengers currently travelling by bus already have the option of using the train and have rejected it as a substitute. If the bus is no longer available it is unlikely that all these passengers would simply transfer their journeys to rail. Instead they may use a competing bus service, make fewer journeys (bus is a significant mode for discretionary travel), or make more journeys at off-peak times.

8.7 Bus and rail are often poor substitutes because the characteristics of both are very different. The OFT noted in particular that journey times on the two modes can be very different. In this context the OFT stated in its Decision, "One third party commented that competition between the two modes of transport was keenest where journey times are most similar". Journey time is merely one journey characteristic that needs to be taken into account in terms of looking at whether bus and train are potential substitutes, the mere fact that journey time is similar merely means the flow cannot be discounted on that basis – it does not infer that competition is keenest on those flows.

8.8 The OFT's Decision also stated, "Several third parties identified routes (into Glasgow and Edinburgh) used by commuters where, they stated, express bus services had been introduced to compete with parallel rail services". The OFT did not provide details to First of those routes and therefore First was not given the opportunity of responding on that point.

8.9 Nevertheless, the OFT concluded, focusing on those flows where the overlapping rail and bus journey times were broadly comparable and the merged entity would be the sole provider of public transport, that: "It appears difficult to identify particular point-to-point routes where all of the route characteristics are consistent with bus-rail competition". First agree with that conclusion.

8.10 The foregoing (and previous authorities) suggest that there is no concern about a particular point-to-point flow if competition between bus and rail is so weak, due to amongst other things differences in journey characteristics, that they are in different product markets on that flow. This will be the case, for example, where:

(a) journey times by rail are much shorter than by bus – the OFT discounted flows where the bus journey time was more than double the rail journey time;

(b) the fares are very different; or

(c) the number of bus passengers on the flow is small, indicating that train has a decisive advantage over bus. In connection with this, the Competition Commission has decided that it is not currently concerned about de minimis flows: those flows with a minimum of 1000 passengers or £5,000 revenue (for bus), or a ratio of bus to train passengers of less than 10%.

8.11 First has analysed the overlap flows and eliminated flows if they meet the above criteria. The results are contained in Appendix 10, and the analysis further explained.

8.12 Table 1 below summarises the main results. It provides the total number of overlap flows and the number of flows after the filters have been applied. It also contains information on the relative importance of each filter. The result is that from 787 overlap flows only 177 remain 22%.

8.13 Table 2 presents the bus revenues for the flows estimated by First, and the effect of the filters. First's estimated revenue on the remaining flows is approximately ***[confidential information*[41]*]***, representing just ***[confidential information]*** of the combined revenue of First Glasgow and First Edinburgh ***[confidential information]***. Table 3 represents similar revenue information for rail, with the remaining flows representing ***[confidential information*[42]*]*** representing just ***[confidential information]*** of ScotRail's turnover (not including SPTE service revenue).

Table 1: Number of overlap flows

		Reason for discarding the flow									
	Total overlaps	Bus journey takes twice as long or more		The bus is more expensive		De minimis criteria		**Total discarded**		**Remaining flows**	
ABERDEEN	1	1	100%	1	100%	0	0%	1	100%	0	0%
GLASGOW	620	307	50%	275	44%	126	20%	489	79%	131	21%
EDINBURGH	166	94	57%	22	13%	61	37%	120	72%	46	28%
Total	787	402	51%	298	38%	187	24%	610	78%	177	22%

[41] ***[confidential information]***
[42] ***[confidential information]***

Table 2: Bus revenues from the remaining overlap flows (in £'000s)

	Total overlaps	**Reason for discarding the flow:** Bus journey takes twice as long or more		The bus is more expensive		De minimis criteria		**Total discarded**		**Remaining flows**	
ABERDEEN	213	213	100%	213	100%	0	0%	213	100%	0	0%
GLASGOW	7,493	4,179	56%	3,314	44%	2,848	38%	4,783	64%	2,710	36%
EDINBURGH	[896	471	53%	114	13%	147	16%	533	59%	364	41%
Total	8,602	4,863	57%	3,641	42%	2,995	35%	5,528	64%	3,074	36%

Note: In three cases in Edinburgh, the service was re-routed and increased to an all day service from 30 June 2003. Figures were based on 2002/03 financial year when Wallyford Station was not served. Thus, zero revenues have been placed for the above calculations but have not been filtered by the de minimus criteria.

Table 3: Rail revenues from the remaining overlap flows (in £'000s)

	Total overlaps	**Reason for discarding the flow:** Bus journey takes twice as long or more		The bus is more expensive		De minimis criteria		**Total discarded**		**Remaining flows**	
ABERDEEN	171	171	100%	171	100%	0	0%	171	100%	0	0%
GLASGOW	19,081	10,362	54%	1,988	10%	9,017	47%	14,317	75%	4,764	25%
EDINBURGH	10,735	9,656	90%	102	1%	8,102	75%	9,953	93%	782	7%
Total	29,987	20,189]	67%	2,261	8%	17,119	57%	24,441	82%	5,546	18%

There are significant competitive constraints from other bus operators

8.14 Even if there were an element of substitutability on specific point-to-point flows it would be very small in relation to the total market for public transport in the area given the relatively small number of overlap flows in the context of the parties' networks as a whole. First does not consider that it is necessary to define precisely what element of competition might, or might not, be lost on those flows if First were to win the ScotRail franchise as it would not, in any event, be in a position where it had the opportunity to raise fares or reduce service levels due primarily to the significant levels of competition it's bus services face from other bus operators and in certain circumstances from coach operators.

8.15 In the NEG/Central inquiry[43], the MMC concluded that where there was existing competition to NEG's coach services from inter-urban bus services, it was satisfied that this was sufficient to deter NEG from exploiting its position if it should also own Central.

8.16 In particular there is no concern about an individual point-to-point flow if competition from other bus operators will constrain post merger behaviour. This will be the case where:

(a) there is already a competing operator on the flow;

[43] Paragraph 2.96(a)

(b) a competing operator could easily extend its network to cover the flow because:

- it already competes on another part of the route of the relevant First service; or
- it operates a route nearby and could easily divert or extend that route; or
- given its current operations and depot location it could enter the route.

8.17 Section 6 explains the significant levels of competition (both actual and potential) currently faced by First. As part of the response to the Economic Questionnaire, First has analysed the overlap flows on which it faces competition. First already faces competition from other bus operators on 53% of the overlap flows (in number)[44]. It has also considered on the basis of criteria fully explained in the response to the Economic Questionnaire, where a competing operator could easily extend its network to cover flows where there is currently no competing operator in response to fare and/or service changes or withdrawal by First. Such analysis shows that First faces potential entry on all flows where it does not currently face actual competition.

There are constraints from other flows on the same route and from the network

8.18 On many flows there will be no incentive for First to raise prices or reduce service levels because it cannot do so without jeopardising revenues from other parts of the route, or from other parts of its network.

8.19 First cannot raise its fares by 5% on an isolated part of most routes. Many passengers use zonal tickets where the fare is the same for any journey within a zone (typically sold using day tickets or other period passes). This fare structure is (a) quick to administer on bus, cutting down journey times and costs (b) has been found to encourage more use of buses by passengers who find it simple, flexible and fair. Based on the financial year to date for 2003/04, ***[confidential information]*** of First Glasgow's passenger journeys are undertaken using zonal tickets including the multi-operator Zonecard.

8.20 First's single tickets are not zonal. But even for these there are restrictions on its ability to raise the fare of an individual flow.

8.21 First could not raise the fare on an individual flow if that means the fare for a flow is higher than for a longer journey that covers the same flow, but continues beyond it. Passengers would consider that First was acting unfairly, reducing general perceptions about the value for money of bus travel and increasing the impression that the cost of a journey is arbitrary and unpredictable. As noted above, the experience of bus operators such as First is that passengers rely more on the bus when they consider the fare structure to be transparent and fair. They are also less likely to fare dodge.

8.22 This last point is particularly important because any attempt to set a higher price for that part of the route may fail because it would be very easy for passengers to evade the higher fare. The fact that one bus route serves many overlapping flows would allow passengers who wanted to travel only on the flow in question to pay a lower fare by claiming that they intended to make a longer journey. If the fare structure was considered unfair then inhibitions against fare dodging may be lower.

8.23 Moreover First cannot affect service levels on an individual flow. Each bus route carries a number of different flows. Any change to the service levels (or quality) on one

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[44] First Edinburgh 47% (78 flows) and First Glasgow 55% (344 flows)

flow will affect First's revenues from the whole route, so that commercial decisions about service levels will not be made at the level of individual flows. In addition, First is likely to face competition from other bus or coach operators on at least some part of the route and would risk losing passengers to that competitor.

8.24 The above suggests that flows will not be a concern where the fare is constrained by fares on related flows, and where the flow is not a critical part of the route as a whole.

Threat of predation is not a barrier to entry

8.25 The OFT put to First in the course of its consideration of the merger that the threat of predation by First would deter new entry on the relevant bus routes, and so undermine potential entry as a source of competitive constraint.

8.26 For the reasons given above in Section 7, First do not consider it to be a credible proposition that other operators fear predation by First.

There is no incentive to divert passengers where the bus fare is higher

8.27 The train fare is sometimes lower. Diverting passengers from bus to train will certainly lead to lower revenues on those routes where the bus fare is higher than the train. Of the routes looked at by the OFT[45], 73% of the Edinburgh flows and 76% of the Glasgow flows at off-peak times and 21% of the Edinburgh flows and 62%f the Glasgow flows at peak times fall into this category.

8.28 This suggests we can exclude from the analysis those flows where the bus fare is already higher than the train fare.

8.29 In addition, attempting to divert passengers from bus to rail by reducing services will not lead to lower costs since First will still need to serve the parts of the route that do not compete with rail.

Capacity constraints on rail

8.30 ***[confidential information]***

There is no incentive to divert passengers where rail revenue is shared with stakeholders

8.31 If, as First believes will be the case, revenue risk on rail will be at the very least divided between the franchisee, the SRA and SPTE, or SPTE taking revenue risk in Strathclyde, this is likely to materially reduce the incentive to undertake this hypothetical strategy.

The Undertakings prevent price increases

8.32 First is the subject of fare undertakings that effectively mean that it cannot raise fares on individual flows in the whole of Central and South East Scotland (including Strathclyde but excluding the City of Edinburgh). The Undertakings provide that for the purpose of calculating the increase allowed on a basket of fares that all fare values rise by the same amount across the network (or route in some limited cases).

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[45] Those flows where the overlapping rail and bus journey times were broadly comparable and the merged entity would be the sole provider of public transport.

8.33 First is also the subject of behavioural undertakings that restrict its ability to reduce its level of service. Within the unitary authority areas of Stirling, Clackmannanshire, Falkirk, West Lothian, Midlothian, East Lothian and the Scottish Borders, First may not reduce the registered mileage operated by its commercial services, to less than 95% of the registered mileage operated by its commercial services as at January 2002 without obtaining the OFT's prior written consent. First monitor compliance with this undertaking and currently First are running, as at the week commencing 1 December 2003, at about ***[confidential information].*** Therefore, within the area mentioned above First could not cut service provision much more without approaching the OFT for its consent, and clearly such consent would be withheld unless First could justify such reduction for good reason. This undertaking does not affect Glasgow.

8.34 The following statement by the OFT in its Decision is therefore incorrect, ".. these undertakings do not cover the whole area under consideration and do not prevent alterations on specific routes.." They do prevent fare alterations on specific flows but not service level changes, where it is accepted some flexibility would remain.

The OFT's conclusion

8.35 In conclusion, the OFT stated that, "**there appeared to be considerable weight to the arguments advanced by First. The constraints First identifies (in particular the SBH undertakings and the need to rearrange services to escape them) would seem largely to frustrate a hypothetical strategy of inducing passengers to switch to rail. It is probable that the number of routes that would escape these constraints would be small. As a result, any extra revenue gained would be relatively low, thus weakening the incentive to adopt such a strategy.**"

9 List of Appendices

1 The ScotRail franchise bid process, the nature of the proposed transaction and rationale for the bid

2 Background on FirstGroup plc

3 FirstGroup's operations in Scotland

4 Background on the ScotRail franchise

5 History of the dealings between FirstGroup plc and ScotRail

6 The FirstBus/SB Holdings merger inquiry and subsequent behavioural undertakings

7 Overlap flows – First/ScotRail

8 Changes that have taken place in the bus markets since the MMC's Report in January 1997

9 Competitors to First

10 Rail and bus are in different product markets – spreadsheets referred to in Section 8, paragraph 8.11

Appendix 1

The ScotRail franchise bid process and rationale for the bid

The bid process

A1.1 The Strategic Rail Authority ("**SRA**"), the government agency responsible for managing passenger rail franchises, has sought bids in relation to the ScotRail franchise. The SRA formerly started the competition for the re-letting of the franchise on 21 October 2002, when it sought expressions of interest. The franchise is currently owned and operated by National Express.

A1.2 First is one of the three remaining shortlisted bidders for the ScotRail franchise, the others being: Arriva and National Express (the incumbent). NS/Serco was shortlisted but withdrew.

A1.3 The term of the franchise currently being let is 7 years with a possible 3 year extension at the SRA's discretion.

A1.4 Drafts of the invitation to tender and the franchise documents were received by the shortlisted bidders at the end of July. The deadline for delivery of bids to the SRA (following a 90 day bid period) was 27 October 2003. The Competition Commission has previously received copies of the relevant documents. Following submission of the bid, there was a period during which the SRA put formal written questions to, and conducted clarification meetings with, First to clarify aspects of the bid.

A1.5 ***[confidential information]***

A1.6 ***[confidential information]***

(a) ***[confidential information]***

- ***[confidential information]***
- ***[confidential information]***

(b) ***[confidential information[46]]***:

- ***[confidential information]***
- ***[confidential information]***

A1.7 ***[confidential information]***

A1.8 ***[confidential information]***

A1.9 All train operating companies ("TOCs") are subject to regulation by the Rail Regulator and the SRA. The controls exercised by the SRA, and also in the case of the ScotRail franchise Strathclyde PTE and the Scottish Ministers, are explained in Section 5 of this Submission.

[46] ***[confidential information]***

Rationale for the bid

A1.10 With respect to UK Rail operations, First's strategy is to bid for all UK Rail franchises as they arise until the Group's portfolio of businesses is deemed to be at an appropriate level and mix. First is a Scottish company, based in Scotland with strong relationships with the stakeholders. First believes it can bring great benefits to the franchise in terms of its management, relationships in Scotland and marketing skills and that these combined with the opportunities for integration, that are not being pursued at present, will bring considerable benefits to the travelling public in Scotland.

Appendix 2

Background on FirstGroup plc

Brief history and principal activities

A2.1 FirstGroup plc (a Scottish registered company listed on the London Stock Exchange) was formed in June 1995 to effect the merger of two existing UK listed bus companies, Badgerline Group plc ("**Badgerline**") and GRT Bus Group plc ("**GRT**"). At the time, Badgerline and GRT operated buses in Aberdeen, Bristol, West Midlands, Yorkshire, the Potteries, South Wales, the South Coast, Edinburgh and the Lowlands of Scotland, the East Midlands and East Anglia.

A2.2 Today, First is a UK based international transport company which in the year to March 2003 had a turnover (before exceptional items) of £2.3 billion, and made pre-tax profits before interest of £189 million. It has three core divisions, as follows:

	Turnover (£m)	Profit before interest (£m)
UK Bus	859	110
UK Rail	842	58
N. America	582	32
Group items	7	(11)
	2290	**189**

Source: First Report and Accounts.

UK Bus

A2.3 Following the formation of First, the company grew through a number of acquisitions. Most notably, in April 1996, it acquired Greater Manchester Buses North (Holdings) Limited for £47 million and in September 1996, First acquired S B Holdings Limited ("**SBH**") for £110 million.

A2.4 In September 1996, the acquisition of SBH was referred to the then Monopolies and Mergers Commission. Shortly after the MMC's conclusions were published (January 1997) Stagecoach entered the Strathclyde bus market, the case was reviewed and subsequently behavioural undertakings were accepted as sufficient to address the adverse effects identified. More detail on the background to, and the thinking behind the behavioural undertakings are contained in Appendix 6.

A2.5 In March 1997, First entered the London bus market with the acquisition of CentreWest for £24 million. First initially acquired a minority stake in Mainline Partnership Limited, a Sheffield-based bus operator, in July 1998 and then acquired the remainder of that company in a transaction valuing Mainline at some £64 million. Also in July 1998, First acquired London bus operator Capital Citybus for £14.1 million.

A2.6 First is currently the largest UK bus operator, with a UK national market share of around ***[confidential information]*** per cent. Its principal bus operations are listed below:

Region/name	Geographic area of operation
South West First Devon & Cornwall	Operates in most of Cornwall, North Devon, and South Devon as far east as Torbay, including Totnes and Newton Abbot.
First Bristol	Local bus services within the Greater Bristol urban area

Region/name	**Geographic area of operation**
First Avon & Somerset	Operating mainly in and around Weston-super-Mare, Wiltshire, South Gloucestershire, Bath and Somerset providing local and rural services
South East First Hampshire & Dorset	Local bus services in and around Southampton, the Fareham and Portsmouth areas, and Dorset
First Beeline	Local and inter-urban bus services in and around the Berkshire towns of Bracknell, Wokingham, Slough, Windsor and Maidenhead
First Essex	Services throughout Essex
East Anglia First Eastern Counties	A mixture of urban and inter-urban/rural services mostly in Norwich and Suffolk
Wales First Cymru	Operates a network of local bus services mainly in and around the Swansea and Port Talbot areas in south west Wales
Midlands First Wyvern	Operations extend to Shrewsbury, Gloucester, Birmingham and from the Welsh Borders with Hereford, Worcester, Redditch, Evesham and Kidderminster being the main centres
First Northampton	Local bus services within the town of Northampton
First Leicester	The City of Leicester and its immediate surrounding area
North West First Manchester	North Manchester, Bolton, Bury, Rochdale, Oldham, Wigan, Salford and Tameside
First Potteries	Serves North Staffordshire with services running to Buxton, Sheffield, Uttoxeter, Derby, Stafford, Shrewsbury, Crewe, Chester and the Wirral
Yorkshire and North Humberside First West Yorkshire	The areas of Leeds, Bradford, Huddersfield and Halifax
First South Yorkshire	Operates networks in Sheffield, Rotherham and Doncaster
First York	In and around York
Scotland First Aberdeen	Bus services within the City of Aberdeen
First Edinburgh	Mainly inter-urban services in the Edinburgh, Lothian areas, and the Borders. Also mainly rural bus services in and around the Stirling and Falkirk areas
First Glasgow	Services in the City of Glasgow and surrounding areas
London First London	Operates in north, north east, south east and west London. The vast majority of services are operated on behalf of TfL
Tram Operations Limited	Operates the Croydon Tramlink light rail system

UK Rail

A2.7 In February 1996, First entered the newly-privatised UK rail market through the acquisition of a 24.5% stake in Great Western Holdings Limited, the holder of the Great Western rail franchise. In March 1997 the North Western franchise was awarded to Great Western Holdings. First tendered for and won the seven year Great Eastern Rail franchise in January 1997. The remaining 74.5% of Great Western Holdings was acquired in March 1998 for £104.8 million.

A2.8 In July 2003, First acquired a majority stake in GB Railways Group, a merger that was cleared unconditionally by the OFT on 30 September 2003. GB Railways is a UK based passenger and freight railway business, operating in the UK and overseas (Europe). In the UK its operations consist of passenger rail services and rail freight through Hull Trains, Anglia Railways and GB Railfreight.

A2.9 In addition, on 31 July 2003, the SRA announced that the joint venture between First and Via G.T.I UK Limited ("Keolis") had been selected as the preferred bidder for the TransPennine Express ("TPE") franchise. The TPE franchise is a new UK franchise. The joint venture parties signed the franchise agreement on 24 September 2003, and the franchise commenced on 1 February 2004. That transaction fell within the ECMR and the Commission decided not to oppose the transaction and declared it compatible on 8 December 2003.

A2.10 First is currently the operator of six TOCs:

Name	Franchise area	Franchise expiry date
First Great Western	High speed train services between London Paddington, South Wales, Thames Valley, the Cotswolds and the West, South Wales and South West	2006
First Great Eastern	Predominantly commuter services from London Liverpool Street to the Shenfield, Southend, Chelmsford, Colchester, Clacton and Ipswich areas	April 2004
First North Western	Local and regional passenger rail services in North Western England and North Wales; inter-urban services between some of the larger towns and cities in the region; urban services around Manchester and Liverpool; and rural services in North Wales, Lancashire and Cumbria.	2004
Anglia	Passenger train services in Eastern England, including the mainline service from London to Ipswich and Norwich and connecting local services in East Anglia	1 April 2004
Hull Trains	Services between London King's Cross and Kingston-upon-Hull	No franchise - operates under a track access agreement that expires in 2010.
TPE	Services on principal inter-city routes across the North of England; including services between Liverpool, Manchester, Leeds, York, Newcastle and Sheffield	2012 (subject to an option to extend to 2017)

Source: GB Railways Annual Report/First.

A2.11 On 4 November 2003, First was selected by the SRA as the preferred bidder for the new Thames Trains franchise. The term of the franchise is 2 years and will run from 1 April 2004 to 31 March 2006. The Franchise Agreement is expected to be signed shortly. The transaction is a relevant merger situation under the Enterprise Act 2002 and First submitted a Notification to the OFT on 23 January 2004.

A2.12 The Thames Trains franchise operates services from London Paddington throughout the Thames Valley to the Kennet Valley, the Cotswolds, up to Stratford-upon-Avon, and on the North Downs line between Reading and Gatwick Airport.

A2.13 The current programme of refranchising will lead to all of First's franchised passenger rail operations being retendered in the next three years (save for TPE) - with three of the four up for renewal in 2004:

- **Great Eastern and Anglia** – to be merged in 2004 with the West Anglia part of the West Anglia Great Northern franchise. This franchise (known as Greater Anglia) has been awarded to National Express and consequently First will no longer hold these franchises beyond 31 March 2004.

- **North Western** - the SRA plans to re-distribute what is currently the First North Western franchise into three new franchises: Wales and Borders, Northern and TPE. Arriva operates the Wales and Borders franchise, First is a party to the joint venture that has been awarded the TPE franchise and bidding on its own, has been chosen as one of the two preferred bidders for the Northern franchise.

A2.14 As well as First being involved in the above mentioned bids (and that for ScotRail), First has also pre-qualified for the new Integrated Kent Franchise along with three other bidders. *Source: SRA press release 22 December 2003.*

Other UK

A2.15 In December 1997, First acquired a 51% share in Bristol International Airport (with the remainder being retained by Bristol City Council). This 51% stake was sold in January 2001. Through an alliance with New World Development Company, First acquired a franchise to operate bus services in Hong Kong. In May 2000 First sold its 26% stake in this operation for £38.7 million.

A2.16 First is the operator of the Croydon Tramlink system, and is involved in a number of consortia bidding for other light rail projects in the UK.

Europe

A2.17 GB Railways has a minority interest in Edelaraudtee AS, a passenger and freight railway operation in Western Estonia.

A2.18 In December 2003, First acquired 90% of a small Dublin-based company which operates high quality coach services between Dublin airport and the city centre under the brand "Aircoach." This acquisition does not appear in the organisational chart referred to below.

North America

A2.19 In September 1999, First acquired the US school bus, transit and vehicle maintenance service operations of Ryder Holdings for $US 940 million. Since this acquisition, the North American business has grown through small acquisitions and contract wins, including school bus and transit operations in Canada.

Organisational structure

A2.20 An organisation chart showing the details of the main companies within First is attached at the end of this Appendix. Please note that the very recent acquisition of the TPE passenger rail franchise by the First/Keolis joint venture is not featured on the attached chart. First holds 55% of the JV company which holds the TPE franchise, with the remaining 45% being held by VIA GTI UK Limited, a subsidiary of the French transport operator Keolis.

Financial structure

A2.21 As stated above, in the year to 31 March 2003, Group turnover was £2,291 million with profit before interest of £189 million. In the six months to 30 September 2003 turnover was £1,127.7 million with operating profit (before goodwill amortisation, exceptional items and profit on disposal of fixed assets) of £78.1 million.

A2.22 The table below sets out a summary of First's profit and loss account for the last five years ended 31 March:

£m	2003	2002	2001	2000	1999
Turnover	2,291.0	2,164.1	2054.0	1795.1	1470.4
Total operating profit	179.7	167.2	134.9	161.1	121.9
Retained profit	52.0	65.4	83.4	56.9	43.3

A2.23 The table below sets out a summary of First's balance sheet of the last five years as at 31 March:

£m	2003	2002	2001	2000	1999
Fixed assets	1,273.2	1,346.0	1,327.7	1,289.9	590.6
Current assets	456.0	412.3	381.2	379.3	266.0
TOTAL ASSETS	1,729.2	1,758.3	1,708.9	1,669.2	856.6
Creditors	1,202.4	1,225.3	1,214.4	1,283.3	772.6
Provisions	124.0	110.7	35.0	39.9	30.4
Equity shareholders' funds	401.7	421.3	458.6	336.2	46.0
Minority interests	1.1	1.0	0.9	9.8	7.6
TOTAL LIABILITIES AND EQUITY	1,729.2	1,758.3	1,708.9	1,669.2	856.6

Appendix 3

FirstGroup's operations in Scotland

A3.1 Within Scotland, First has only bus operations, it does not have any passenger rail interests. Brief details of First's bus operations in Scotland are set out below:

A3.2 **First Aberdeen** operates services throughout the City of Aberdeen. First Aberdeen has only one bus depot in King Street, Aberdeen. It operates a fleet of approximately ***[confidential information]*** vehicles. In the year to 31 March 2003 it generated a turnover of £18.727 million.

A3.3 **First Edinburgh** operates a mixture of urban and inter-urban/rural services and has a core operating area that covers the unitary authority areas of Stirling, Falkirk, Clackmannanshire, West Lothian, Midlothian, East Lothian, the City of Edinburgh and the Scottish Borders. First Edinburgh currently operates a fleet of approximately ***[confidential information]*** vehicles, from 7 depots[47], situated at Bannockburn, Dalkeith, Musselburgh, Larbert, Linlithgow, Livingston, and Galashiels. In the year to 31 March 2003 it generated a turnover of £36.564 million.

A3.4 **First Glasgow** operates a mixture of urban and inter-urban services mostly in the unitary authority areas of Glasgow City, East and West Dunbartonshire, North and South Lanarkshire, East Renfrewshire and Renfrewshire (all within the SPTE administered area)[48]. In the year to 31 March 2003 it generated a turnover of £94.304 million.

A3.5 First Glasgow currently operates a fleet of ***[confidential information]*** vehicles from 7 depots located in Cumbernauld, Dumbarton, Scotstoun, Motherwell, Larkfield, Parkhead and Stevenston. First Glasgow's fleet is currently split between the depots as follows:

Depot location	**No. of vehicles**
Cumbernauld	***[confidential information]***
Dumbarton	***[confidential information]***
Scotstoun	***[confidential information]***
Motherwell	***[confidential information]***
Larkfield	***[confidential information]***
Parkhead	***[confidential information]***
Stevenston	***[confidential information]***
Total	***[confidential information]***

[47] With outstations as follows: for Bannockburn, one at Balfron; and for Musselburgh, one at North Berwick.
[48] Save for two services operated jointly with First Edinburgh.

Appendix 4

The ScotRail franchise network

A4.1 The ScotRail franchise is responsible for the operation of approximately 95% of the passenger rail services in Scotland, of which approximately 50% are operated on behalf of the Strathclyde Passenger Transport Executive ("**SPTE**").

A4.2 In the year to 31 December 2002, ScotRail Railways Limited (the current operator of the ScotRail franchise), had a turnover of £367.9 million (including franchise payments but excluding passenger revenue for the SPTE services which is retained by SPTE), and made a pre-tax loss of £10.5 million. If SPTE revenue were included, then the SPTE revenue (including revenue grant) would account for some 48% of ScotRail's turnover.

A4.3 The ScotRail services provided include:

- Strathclyde services in west central Scotland centred on the Glasgow conurbation;
- inter-urban services between major Scottish cities;
- urban services, principally in and around Edinburgh;
- sleeper services Aberdeen, Edinburgh, Glasgow, Inverness and Fort William, and London Euston; and
- rural services in the north and west Highlands, north east Scotland and south west of Scotland.

A4.4 A copy map showing the network operated by ScotRail is attached to this Appendix. Also attached is a rail network map showing the services operated on behalf of SPTE (also available at www.spt.co.uk). ScotRail's services run over some 3000 route kilometres and it operates 335 stations.

Appendix 5

History of the dealings between FirstGroup plc and ScotRail

A5.1 First's dealings with ScotRail relate largely to multi-modal ticketing initiatives and bus/rail links and examples of these are listed below:

(a) PlusBus – this is a nationwide initiative to encourage integration between bus and rail. First administers schemes based around Aberdeen, Bathgate, Falkirk Grahamston, Falkirk High, Larbert, Linlithgow, Livingston North, and Stirling stations with a Greater Glasgow scheme launched in January 2004, which all involve ScotRail.

(b) Regional integrated ticketing – First and ScotRail both participate in the regional schemes in the SPT area (Zonecard) and in the SESTRANS area (One-Ticket). ScotRail's current involvement in SESTRANS is limited to the North Berwick line.

(c) Haddington to Newcraighall link – this initiative was proposed by First to ScotRail and has recently been put in place. It provides a new bus service link from Haddington to Newcraighall, specifically timetabled and with a through ticket, to allow passengers to join the rail network at Newcraighall and travel into Edinburgh.

A5.2 First has also bid for and operated some contracts put out by ScotRail to bus operators, to provide emergency cover for when the rail network is closed due, for example, to incidents or engineering works.

Appendix 6

The FirstBus/SB Holdings merger inquiry and subsequent behavioural undertakings

The First/SBH merger reference in 1996

A6.1 In June 1996, First (then FirstBus plc) acquired 100 per cent of the issued share capital of SB Holdings Limited ("SBH"). The acquisition was referred by the Secretary of State to the Monopolies and Mergers Commission ("MMC") for further investigation on 23 September 1996. The MMC had to consider First's bus operations in central and south-east Scotland, but excluding Aberdeen.

A6.2 In the FirstBus/SBH inquiry, in 1996, based on registered mileage, the MMC concluded that FirstBus/SB Holdings had the following market shares:

Area	**%**
City of Glasgow	90
Designated area[49]	61

A6.3 In previous MMC inquiries involving SBH[50], the MMC concluded that the greatest competitive threat to a bus operator with a strong presence is likely to come from actual and potential competition from other major operators in contiguous areas. In looking at the likely effects of the merger the MMC considered the level of actual competition faced by First from large and small operators, and also the potential for competition.

A6.4 The MMC concentrated on actual and potential competition from large operators. In terms of large operators in the "designated area", the MMC identified the following:

British Bus (now Arriva plc) – it operated to the west of Glasgow, primarily in Inverclyde and Renfrewshire. It had three depots at Inchinnan, Johnstone and Greenock and a fleet of 340 vehicles. Of these Inchinnan is located 10 miles from central Glasgow and Johnstone, 12 miles. At that time British Bus competed against SBH in three areas: Linwood to Paisley, Paisley to Glasgow and Govan to Glasgow. Shortly after the First/SBH merger, Cowie acquired British Bus.

Lothian Regional Transport (now Lothian Buses plc) – it operated in Edinburgh, East Lothian and Midlothian with 537 vehicles based in three depots in Edinburgh.

Stagecoach – operated Western Buses with a fleet of 445 buses in a wide area south of Glasgow with its closest depot to Glasgow some 23 miles away at Kilmarnock. Stagecoach had two other subsidiaries to the north and east of what was then referred to as Midland Bluebird's operating area: Bluebird Buses covering the area surrounding Aberdeen and Fife Scottish operating mainly in Fife but also providing inter-urban services to Perth, Edinburgh, Glasgow and Dundee. There two subsidiaries had about

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[49] This area comprised the operating area of FirstBus and S B Holdings: the unitary authority areas of Argyll and Bute, East Dunbartonshire, Renfrewshire, Glasgow City, North Lanarkshire, South Lanarkshire, West Dunbartonshire and East Renfrewshire, Falkirk, Stirling, City of Edinburgh, West Lothian, Scottish Borders, Clackmannanshire, East Lothian and Midlothian.

[50] S B Holdings Limited and Kelvin Central Buses Limited, Cm2829, April 1995 and Stagecoach Holdings plc and S B Holdings Limited, Cm2845, April 1995.

665 vehicles. At the time of the inquiry however, Stagecoach was not a significant actual competitor to SBH.

A6.5 The MMC noted a large number of small operators operating within the designated area, particularly in and around Glasgow City. Despite what it saw as the profusion of bus operators particularly in Strathclyde, in general the extent of competition between operators at the route level appeared, to the MMC[51], limited.

A6.6 The MMC concluded that the merger would have adverse effects due to the following:

(a) it would eliminate competition between First and SBH;

(b) it was likely to significantly reduce the level of potential competition from Stagecoach Holdings plc and the then British Bus (which was acquired by Cowie Group plc (now Arriva plc)) in Strathclyde;

(c) it was likely to significantly reduce the level of potential competition from other large operators in the rest of central and south-east Scotland; and

(d) it would deter entry into the market by others.

A6.7 It is clear that the following factors were central to the MMC's conclusions that the First/SBH merger was likely to operate against the public interest:

- the likelihood of aggressive action by Stagecoach in Glasgow was too remote to place any weight on it. This view was encouraged by Stagecoach who gave evidence that it had no intention of taking on First;
- there was no indication in Cowie's evidence that it was interested in taking on First;
- in terms of Lothian Buses, and despite evidence of previous intense competition with First, the MMC concluded it was unlikely that the then LRT would engage in intensive competition with the largest bus operator in the UK; and
- whilst evidence from third parties on the effect of the merger was mixed, the MMC placed much weight on the SPTA/SPTE view that small operators would be reluctant to compete too vigorously against such a powerful operator as First. The MMC did not see small operators as a serious competitive threat to First.

A6.8 The MMC recommended that First divest its Falkirk-based Midland Bluebird subsidiary and part of its Strathclyde operations.

Events following the publication of the MMC's report on 24 January 1997

A6.9 Within 6 weeks of the publication of the MMC's Report in March 1997, Stagecoach announced its intention to operate new bus services in the Greater Glasgow area, something it said it had no intention of doing. It proposed to do this through two of its subsidiaries, Stagecoach Glasgow and Fife Scottish.

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[51] Paragraph 4.41.

A6.10 As at June 1997, Stagecoach had registered 12 new commercial services (radial routes fanning out from the city centre) with a peak vehicle requirement of 63 vehicles. See also Appendix 8. First did not seek to challenge the MMC's decision, rather it requested a review of the case on the grounds that subsequent to the Report there had been substantial and very significant developments in the relevant market. Following the OFT's review of the case, the Director General of Fair Trading ("the Director General") advised the Secretary of State.

A6.11 The Secretary of State announced her decision on 31 July 1998. In that announcement, Mrs Beckett acknowledged the changes in the Glasgow bus market since the MMC report:

> "*Stagecoach's entry … is, I believe, a demonstration that competition in the relevant market is possible*."

A6.12 First also understood, from discussions with the OFT at that time, that the Director General had concluded as a result of the review, and the Stagecoach entry, that there were no longer any adverse effects in the Glasgow bus market.

A6.13 Nevertheless, the announcement stated that concerns remained that the scale and dominance of First following the merger may nevertheless deter entry by others. The Secretary of State therefore announced that she had decided to seek a package of behavioural undertakings. The package of undertakings that the Director General was asked to obtain had two main aims:

(a) firstly, to prevent First from exploiting its market power through undertakings restricting its ability to raise prices and reduce its level of services; and

(b) secondly, seek to protect new entrants, through restrictions on fare and frequency changes, journey intervals and tendered services.

The Undertakings

A6.14 First is therefore currently the subject of behavioural undertakings affecting its bus operations in central and south-east Scotland. The Undertakings were signed by First on 4 December 2001 and accepted by the Secretary of State in January 2002 in accordance with the Director General's advice, a copy of which will be provided in response to the Economic Questionnaire. Whilst the Undertakings were not accepted formally until then, First had nevertheless been giving effect to the principles of the fares undertakings since 1 September 1997 in relation to First Glasgow's operations and since 1 February 1998 for those of First Edinburgh.

A6.15 A copy of the Undertakings will be provided in response to the Economic Questionnaire. The two main elements of the Undertakings are:

(a) a restriction on First's ability to raise fares (the fare cap) – the fare cap applying to a combined area containing some 45% of the population of Scotland[52]; and

(b) restrictions on reductions in levels of service and what First can do by way of competitive response to entrants on routes where it operates.

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[52] Source: OFT press release, the MMC Report into the acquisition by FirstGroup plc of SBH, advice on post reference undertakings.

A6.16 The Undertakings apply to two distinct geographical areas known as the First Glasgow operating area[53] and the Midland Bluebird and Lowland operating area[54] (effectively First Edinburgh's operating area although not including the City of Edinburgh). The fare restrictions applies to all First's operations within both operating areas (marked in red on the map attached). The restrictions on reductions of service level etc. only apply to all First's operations within the Midland Bluebird and Lowland operating area (marked in blue on the map attached).

A6.17 In subsequent negotiations with the OFT, First sought to understand what adverse effects the Undertakings were addressing in each of the geographic areas covered by them. Significantly, the OFT did not require anti-predation undertakings in the First Glasgow operating area and therefore, First concluded, were not concerned that First was sufficiently dominant to deter entry to the Glasgow market. Mrs Beckett's comment, quoted above, evidences the view that Glasgow as a market was and remains contestable. Certainly, the entry by Stagecoach provided additional actual and potential competition to First in Glasgow and demonstrated that the market is contestable.

A6.18 Therefore First considers that the fare controls in Glasgow were to address the OFT's underlying concerns about the effectiveness of future competition in Glasgow, as it was by no means certain in 1998 that Stagecoach would remain in the market. Brief details of Stagecoach's current operations are given in Section 6.

Commencement and duration of restrictions

A6.19 With the exception of the anti-predation undertakings, the Undertakings are unlimited in duration. On 3 September 2003 First submitted a request to the OFT for a review of the Undertakings.[55] First understands that the OFT is awaiting the outcome of the reference before commencing its review.

Fare cap undertakings

A6.20 In both the First Glasgow operating area and the Midland Bluebird and Lowland operating area the Undertakings impose restrictions on First's ability to raise fares through a fare cap on a basket of fares.

A6.21 The fare cap itself operates in two parts: first a fare freeze for a period of 12 months (which has now expired) and then a requirement that the annual increase across a basket of fares will not exceed the percentage change in the RPI index in the preceding year. Due to existing differences in the fares and fare structures between First's operations in east and west Scotland, the fare cap undertaking allows for separate fare baskets for the First Glasgow operating area and the Midland Bluebird and Lowland operating area. The fares included in each basket are all those that First charged on journeys within the First Glasgow operating area as at 1 September 1997 and those charged on journeys within the Midland Bluebird and Lowland operating area as at 1 February 1998. The fare baskets do not include tendered, concessionary, multi operator or discounted fares.

A6.22 To calculate the level of fare increase that may be permitted in any given year, each fare type or value that is included in a fare basket is weighted according to the number of passengers that have purchased the fare type or value over a specified sample period

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[53] Consisting of the unitary authority areas of the City of Glasgow, North Lanarkshire, South Lanarkshire, East Dunbartonshire, West Dunbartonshire and East Renfrewshire.

[54] Consisting of the unitary authority areas of Stirling, Falkirk, Clackmannanshire, West Lothian, East Lothian, Midlothian and the Scottish Borders.

[55] To the Mergers Branch: Bob Gaddes

(which is then annualised). When added together this produces a figure for total revenue. First may either increase or decrease the value of each of the fare types or values as it wishes in any given year, so long as the total yield generated by these alterations (and calculated according to the weighting) does not exceed the percentage change in the RPI index in the preceding year when compared against the figure for total revenue.

A6.23 The effect of the fare cap restriction is such that there is no direct limit on the price that First may charge in relation to a particular fare type or value. However, any significant increase in relation to a particular fare type or value is likely to adversely affect the price of other fare types or values within the basket by either preventing or limiting any increase or even requiring their reduction. Further details of the level of fare increases implemented are contained in the response to the Economic Questionnaire.

A6.24 The fare cap undertakings are themselves supported by undertakings not to change, without obtaining the prior written consent of the OFT, a range of matters relating to the regulated fares including fare stages and zones, peak fare periods and their terms and conditions. First is also required to provide the OFT with spreadsheets and fare tables demonstrating compliance with the fare cap undertakings.

Anti-predation undertakings

A6.25 The package of what can be termed anti-predation undertakings only apply within the Midland Bluebird and Lowland operating area.

A6.26 The anti-predation undertakings include the requirement that where First sets fares lower or operates services at higher frequencies than a competing operator's service and the competing service ceases to operate within 3 years of the date of the Undertakings then First must not for a period of 3 years from the date on which the competitor ceases, without consent:

(a) charge any fare on services which competed with the competitor's service which exceeds the lowest fare charged by it whilst in competition with the competitor's service; or

(b) reduce the frequency of services which competed with the competitor's service below the highest frequency operated by it whilst in competition with the competitor's service.

A6.27 Furthermore, First must ensure that any new commercial bus services operated by it are evenly spaced between those of a competitor so that, for example, where a competitor operates a service every 20 minutes First may only operate a new service at a 10 minute headway as against the competitor's service.

A6.28 In relation to tendered services within the Midland Bluebird and Lowland operating area, First is prevented from providing or operating any new commercial service or increasing the frequency of any existing commercial services in competition with a tendered service for which it had unsuccessfully bid for.

A6.29 Finally, to ensure that First does not materially reduce the level of commercial services that it provides within the Midland Bluebird and Lowland operating area, the Undertakings also require that First must not reduce the registered commercial mileage within the Midland Bluebird and Lowland operating area to below 95% of the registered mileage operated by its commercial services as at January 2002 without obtaining the OFT's consent. First monitors compliance with this undertaking and as at the beginning of December 2003 were at about ***[confidential information].***

Appendix 7

Overlap flows - First/ScotRail

A7.1 Attached are three spreadsheets setting out a list of point to point flows where in the broadest sense bus overlaps with rail (together with information provided to the OFT):

(a) Aberdeen (document no. 2282425)

(b) Edinburgh (document no. 2283364)

(c) Glasgow (document no. 2283895)

A7.2 The following should be noted:

(a) the catchment areas used for bus stops and rail stations is likely to overstate the number of overlap flows. The catchment areas used were as follows:

(i) First Edinburgh - In determining point to point flows in the more rural areas we have listed overlaps where both bus and train serve a settlement regardless of the station/stop locations. In the more urban areas, we have listed bus services and rail routes as overlapping where broadly speaking the catchment area of a rail station overlaps (however slight) with the nearest bus stop on a bus service, using 800 metres for a rail station and 400 metres for a bus stop. These figures have been used by the Department for Transport for many years. This approach is also consistent with the Scottish Transport Appraisal Guidance[56] which advises in determining catchments for the calculation of walking measures, the following criteria can be used as a general guide:

- bus stop (urban) 5 minutes (300-500 metres)
- bus stop (rural) 10 minutes (600-1000 metres)
- rail station 10 minutes (600-1000 metres)

(ii) First Glasgow - The spread of rail stations and bus stops is more dense than the Lothians, and in most cases rail stations are on or near to a main road. Bus stop locations (which are decided by the local authorities) are in general no more than 300 metres apart and in many areas rail stations are less than 500 metres apart. This has a consequence for catchments. In determining point to point flows for bus and rail within Glasgow we have listed bus services and rail routes as overlapping where broadly speaking rail stations are within 300 metres of a bus stop. First do not believe the list of overlaps would change materially if this distance were increased to say 500 metres.

(b) First has no direct observations of the number of passengers on a flow. The only information it has relates to the number of passengers getting on at each stop. It believes that the estimates given for passenger numbers for bus are likely to be overestimates.

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[56] Paragraph 10.6.4 of the Guidance.

Appendix 8

Changes that have taken place in the bus markets since the MMC's Report in January 1997

Market shares

A8.1 In 1996, the MMC estimated First's share of the Glasgow market as 89% (based on registered mileage) and in the City of Edinburgh, 25%; Midlothian, 62%; East Lothian, 45% and West Lothian, 91%.

A8.2 First estimates that its current market share for commercial services within First Glasgow's operating area is ***[confidential information]*** (based on PVR). It should be noted that PVR relates only to commercial services. A large number of the competitors will operate tendered/school contracts and not commercial services and therefore these figures overstate First's share.

A8.3 First estimates current market shares within Greater Edinburgh and the Lothians for commercial services (based on PVR) are:

	%
Lothian Buses	***[confidential information]***
First Edinburgh	***[confidential information]***
Stagecoach	***[confidential information]***
Horsburgh	***[confidential information]***
Others	***[confidential information]***

A8.4 The above figures suggest that since 1996, First's share has fallen markedly, another indication of the level of competition.

Large operators

A8.5 **Stagecoach** announced its intention to enter the Glasgow market in March 1997. Its stated intention was to run 150 buses on city services. Its subsidiary, Stagecoach Glasgow acquired a depot at Dunblane Street, Glasgow, and by June 1997 had registered 12 services, requiring a PVR of 63 buses.

A8.6 Out of those services, one (the X25) was run by Fife Scottish from its Dunfermline depot (40 miles from central Glasgow) with the remaining services were being operated by Stagecoach Glasgow from its Dunblane Street depot. Stagecoach also acquired another depot site at Blochairn just to the north-east of the City Centre. The site (believed to be an old Territorial Army site) covers a very large area (1.5 hectares) and includes warehouse and office space. It is estimated that it has capacity for about 60 vehicles, including maintenance facilities.

A8.7 Both Stagecoach depots were within about four or five miles of all SBH's then four Glasgow depots and the manner in which Stagecoach Glasgow entered the market was to run radial routes that fanned out from the city centre and penetrated into the areas of Pollok, Cumbernauld, Easterhouse, East Kilbride, Castlemilk, Drumchapel and Milton. Stagecoach Glasgow did not compete in one isolated area of the city but sought to make the maximum impact and to compete with SBH on as wide a scale as possible.

A8.8 At the time of the giving of the Undertakings it was by no means certain that Stagecoach would remain in Glasgow, yet some 7 years after entering the Glasgow market, Stagecoach remains, albeit on a slightly smaller scale than when it entered.

A8.9 Today therefore, as well as retaining its operations that are contiguous with First in Glasgow and central Scotland (referred to in the 1997 Report), Stagecoach operates 5 services in the city of Glasgow from its depot in Glasgow at Blochairn with a peak vehicle requirement of approximately 35 buses. The depot at Blochairn has capacity for 60 vehicles. In terms of distance from First's depots in Glasgow, Stagecoach Glasgow's depot at Blochairn is 2 miles from Parkhead, 3 miles from Larkfield, and 5.5 miles from Scotstoun (the First Glasgow depots in Glasgow).

A8.10 All 5 services operated by Stagecoach compete against First Glasgow's services. Four of these (175, 162, X25 and X19 (which have a PVR of 30)) are operated from the Blochairn depot.

A8.11 **Arriva**. A further relevant factor in the context of the Glasgow market and its competitiveness, although not as significant as the major incursion by Stagecoach, was the change in British Bus's (now Arriva's) position.

A8.12 At the time of the Stagecoach/SBH merger, Clydeside was a part of what was perceived to be the ailing British Bus Group. British Bus was acquired by Cowie on 1 August 1996. Cowie gave evidence to the MMC during the course of that inquiry that the acquisition of British Bus has enabled it to become an effective third competitor to the two existing market leaders (First and Stagecoach) and would bring to bus passengers nationwide the benefits of its philosophy of providing a quality bus service to customers.

A8.13 Since then, Clydeside Buses acquired a number of operators in two areas within Glasgow (Inverclyde and Renfrewshire), including operators who competed against SBH.

A8.14 Arriva currently operates ***[confidential information]*** vehicles from its depots at Renfrew and Paisley. At one point it operated ***[confidential information]*** buses although has now withdrawn from the Inverclyde area. Arriva currently operates along 4 main corridors into Glasgow (Glasgow – Paisley – Johnson; Glasgow – Renfrew – Erskine; Glasgow – Renfrew – Paisley; and Glasgow – Pollok – Barrhead), all of which compete against First's services.

A8.15 **Lothian Buses** is today a significant competitor to First in Edinburgh and the Lothians. In recent years, following a change of management, Lothian Buses has extended the reach of its services into East Lothian and Midlothian and has intensified competition against First on frequency and fares.

A8.16 As recently as August 2001, Lothian Buses extended its services to Haddington to the east of Edinburgh and undercut First's fares. Lothian's fleet has also grown, from ***[confidential information]*** in 1996 to, First estimates, ***[confidential information]*** vehicles operating from its three depots in Edinburgh, an increase of nearly 100 vehicles. More detail on the extent of the competition provided by Lothian Buses is contained in the response to the Economic Questionnaire.

Independent operators/overall fleet figures

A8.17 In the 7 years since the Report, there has been material new entry into the Glasgow bus market and significant expansion of existing operators. In all local authority areas in central and south-east Scotland, First faces an increased level of competition from independent operators. Details of the level of competition faced today are contained elsewhere in this Submission and the Economic Questionnaire.

A8.18 In 1996, SBH had a fleet of approximately 1250 vehicles and, it estimated its competitors in Glasgow at that time had a fleet of approximately 1180 vehicles. Those operators listed in Appendix 9 together operate a fleet today of approximately ***[confidential information]*** vehicles, compared to First in Glasgow's fleet of ***[confidential information]*** vehicles, a significant turnaround. First's fleet both in Glasgow and in Scotland has significantly reduced since 1996:

First fleet size in Glasgow and Scotland (approx)

	First in Glasgow Fleet	First in Scotland Fleet
1996	***[confidential information]***	***[confidential information]***
Current	***[confidential information]***	***[confidential information]***

A8.19 The perception was that the Midland Bluebird and Lowland operating area constituted a "safe-haven" for First. Since then, First has faced an increase in actual and potential competition from both large and small operators such that the perception of it being a safe-haven is today misplaced. Across the entire Midland Bluebird and Lowland operating area, First has today a total fleet size of approximately ***[confidential information]*** vehicles (including those operating in Edinburgh). This figure is much less than Lothian Buses' fleet size alone of approximately ***[confidential information]*** vehicles. We compare in the table below, First's total fleet size as against competitors' total fleet:

	First Edinburgh	Competitors' fleet
GEL	[***[confidential information]***	***[confidential information]***
SFC	***[confidential information]***	***[confidential information]***

A8.20 The extent of the competition faced by First is explained in Section 6 by reference to an analysis carried out by First looking at the on-bus revenue generated by its commercial services on which it faced competition as at February 2003.

Appendix 9

Competition to First

A9.1 A list of First Glasgow's main competitors in Glasgow

A9.2 A list showing the increase in the size of independent operator's fleets in Glasgow since 1996

A9.3 A list of First Edinburgh's competitors:

(a) in Greater Edinburgh and the Lothians; and

(b) Stirling, Falkirk and Clackmannanshire.

First Glasgow's competitors in Glasgow

Operator	Depot location	Depot size	
		No. of fleet	Capacity
[confidential information]			

Increase in size of independent operators between 1996 and 2004

Operator	**Fleet**	
	1996	**2004**
[confidential information]		

First Edinburgh's competitors in the Greater Edinburgh and Lothians[57]

Operator	Depot location	Depot size	
		No of fleet	Capacity
[confidential information]			

[57] Scottish Citylink has not been included in this table as it subcontracts in services from other operators and does not have its own fleet.

First Edinburgh's competitors in Stirling Falkirk and Clackmannanshire[58]

Operator	**Depot location**	**Depot size**	
		No. of fleet	**Capacity**
[confidential information]			

[58] Scottish Citylink has not been included in this table as it subcontracts in services to other operators and does not have its own fleet.

Appendix 10

Rail and bus are in different product markets

A10.1 See attached spreadsheet containing the analysis referred to in Section 8, paragraph 8.11.

A10.2 Note: overlap flows are eliminated if:

(a) bus is more expensive: this condition eliminates those flows where the train fare was cheaper than the bus fare.

(b) bus journey takes twice as long or more: all flows for which the ratio of bus travel time to train travel time was greater than or equal to 2 were excluded.

(c) De minimis: this condition is three-fold. If a flow does not meet all of the criteria, it is excluded:

- 1000 passengers: the flow must have more than 1000 passengers.
- £5,000: the bus revenues on the route have to exceed £5,000.
- 10% ratio: flows for which bus offers the same point-to-point service as train are excluded if the ratio of the sum of all bus passengers (for all bus routes that match a given point-to-point service) to train passengers is less than 10%.

Some further considerations:

The data used for fares (attached at Appendix 7) is disaggregated into day/evening or peak/off-peak intervals. In order to discard a route, the above tests must be failed for both parts. In some cases, more than one price for a given flow/interval was provided, such as 2.20/2.90 for peak travel from Motherwell-Hamilton. In each case we have been conservative, and only excluded the route if it passes the test for all prices.