



National Express Group plc and the Greater Anglia franchise

A report on the acquisition by National Express
Group plc of the Greater Anglia franchise

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

The acquisition by National Express Group plc of the Greater Anglia Franchise

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Summary

1. On 27 May 2004 the Office of Fair Trading (OFT) referred the acquisition by National Express Group plc (NEG) of the Greater Anglia franchise to the Competition Commission (CC) for investigation and report. The reference was made under section 22 of the Enterprise Act 2002 (the Act). We were required to publish our final report by 10 November 2004.
2. NEG is the largest train operating group by passenger revenue, and one of its subsidiaries is the largest operator of scheduled coach services in the UK. Within the area served by the Greater Anglia franchise (the Greater Anglia area) it operates a number of coach services which overlap with the Greater Anglia services, in particular between London and a number of localities within the Greater Anglia area, such as Norwich, Yarmouth, Ipswich and Colchester. It also operates the Central Trains franchise, which has services between Peterborough, Cambridge and Norwich, and which overlap with those of Greater Anglia; and the c2c franchise, which includes services between London Fenchurch Street and Southend, Southend also being served by Greater Anglia services from Liverpool Street. The reference was made to us some time after NEG started operating the Greater Anglia franchise, which was on 1 April 2004.
3. In making the reference to us the OFT raised potentially important issues about the effect of the merger on competition in the supply of passenger transport services on point-to-point routes in the Greater Anglia area. In the greater time available to us, however, we were able to investigate in more detail the extent of substitutability between the services, including carrying out two passenger surveys on the main rail and coach routes affected by the merger, and to undertake a detailed analysis of the potential profit incentives of the merged company.
4. The markets affected by the merger, in our view, are those for point-to-point transport journeys in the Greater Anglia area. Passengers' choice between different transport modes for making such journeys depends on a number of aspects of the journey, including the journey cost, the journey time (including the time spent travelling to or from stations or coach stops), and the frequency of the service. Public transport journeys differ significantly from private transport journeys, particularly on routes into central London. It is also appropriate to distinguish leisure travel from commuting and business travel, coach being used predominantly for leisure travel, given the longer journey times.
5. On the effect of the merger on competition between coach and rail services, there were some 16 overlap flows, particularly between London and the Greater Anglia area, on six coach routes, which in our view give rise to possible concern. However, the frequency of coach services on those routes is limited (between two and five services a day) and coach generally has a small share of public transport passengers, suggesting competition between coach and rail services is also likely to be limited. We found there was a modest degree of substitutability for leisure passengers between coach and rail services on these flows. However, it was unlikely that it would be profitable for NEG to raise fares on these coach routes or reduce coach services to attract passengers from coach to rail given, in particular, the loss of network revenues from passengers using these coach services who connect at Victoria Coach Station to other NEG coach services. We also do not believe rail fares would be higher on these flows as a result of the merger (not least because of the extent of regulation), or that there would be any effect on the level of rail services.

6. On the effects of the merger on competition between rail services, we saw little reason for concern about the effect of the merger on services between Peterborough, Cambridge and Norwich. There was no fare competition on these services before the merger. The level of services was primarily determined by the franchise agreements, including the stations the train operators are required to serve. There are alternative bus services operating on most of those generally shorter distance flows between intermediate stations. Finally, there is a larger proportion of leisure traffic on such rural routes, with higher fare elasticity, further constraining any ability NEG may have to impose fare increases.
7. Concern was expressed to us by commuters and commuters associations about the effects of the merger on rail services between London and Southend, particularly the prospect of increases in regulated fares, given a background of recent and planned reductions in capacity on c2c. The actual or potential overlap in catchment areas serving the two lines is largely limited to the Southend area, and only a minority of passengers within that area are likely to have a realistic choice between the two lines. We found the main reason for passengers to use their existing line was proximity to their home and final destination, and speed of journey; switching to the other line would significantly increase the cost of their journey, if the value to passengers of the extra journey time is included. Nonetheless, while there was a degree of substitutability between services on the two lines, this was insufficient to constrain fares on either line below the regulated level, and appears to have had little effect on unregulated fares. Notwithstanding that there is limited substitutability between the two lines, the scope to increase fares or reduce services on either line is limited by regulation; and as regards unregulated fares, the high price elasticity of demand for leisure travel, irrespective of the merger, is itself likely to constrain fare levels.
8. We concluded that the merger has not resulted, and may not be expected to result in any substantial lessening of competition on public transport services in the Greater Anglia area, either between coach and rail services serving the Greater Anglia area; or between different rail services between Peterborough, Cambridge and Norwich or between London and Southend.

Findings

1. The reference

- 1.1 On 27 May 2004 the OFT referred the acquisition by NEG of the Greater Anglia franchise to the CC for investigation and report. The reference was made under section 22 of the Act. Our terms of reference are set out in Appendix A. These require us to consider whether a relevant merger situation has been created and, if so, whether it has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK. We were required to publish our final report by 10 November 2004.
- 1.2 This document, together with the appendices, constitutes our report which we are required to notify to the main parties under the CC's *Rules of Procedure*. Further information, including non-sensitive versions of main party and third party written submissions, summaries of non-sensitive key arguments of third parties, a report detailing the results of our surveys of public transport users in the relevant areas carried out by Synovate Limited UK, and the reports from consultants which we commissioned, as well as our provisional findings published on 23 September 2004 can be found on our web site.¹ We cross-refer to these documents as appropriate.

2. The companies

National Express

- 2.1 NEG is the largest train operating group by passenger revenue and one of its subsidiaries is the largest operator of scheduled coach services in the UK. Its financial performance is summarized in Appendix B. In the year to 31 December 2003, its turnover was some £2,566 million, with operating profit of £135 million.² After interest, tax and exceptional items it recorded a profit for the year of £43 million.

NEG's rail operations

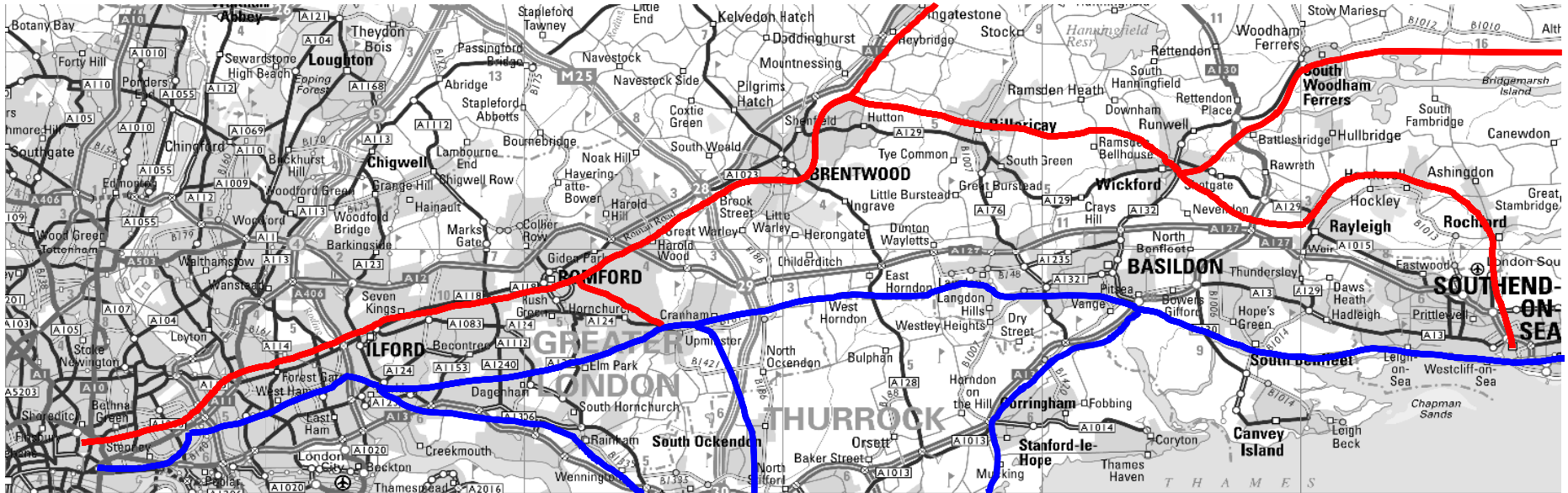
- 2.2 NEG currently operates eight train operating company (TOC) franchises: Central Trains, Silverlink, Midland Mainline, Gatwick Express, c2c, WAGN, Wessex Trains and Greater Anglia. Until mid-October 2004 it also operated the ScotRail franchise, which has now been awarded to FirstGroup, that merger being the subject of a recent inquiry by the CC. As shown in Appendix B the total turnover of these UK rail operations in the year ended 31 December 2003 was some £1.7 billion. Of these, Silverlink, c2c and WAGN have a common management structure known as Londonlines, and share a number of franchise and central support services (for example, finance and human resources functions). The other franchises each have their own independent management structures.
- 2.3 The Greater Anglia franchise includes the West Anglian services that were formerly part of NEG's WAGN franchise (see paragraph 2.9(c)). Two of the other NEG franchises also have operations close to, or extending into the Greater Anglia area (by which we mean the area of operation of the Greater Anglia franchise):

¹www.competition-commission.org.uk.

²Before goodwill amortization and exceptional items.

- (a) c2c operates from Fenchurch Street–Southend and beyond to Shoeburyness. (Figure 1 shows the different c2c and Greater Anglia routes to Southend.)
- (b) Central Trains operates services in the northern part of the Greater Anglia area, between Peterborough and Norwich, and Peterborough and Stansted via Cambridge (see Figure 2). Both are parts of much longer routes from Birmingham and Liverpool. The operations of Central Trains in the Greater Anglia area are a very small part of its activities, which are based in the West Midlands but extend from Liverpool–Norwich.

FIGURE 1
London–Southend lines

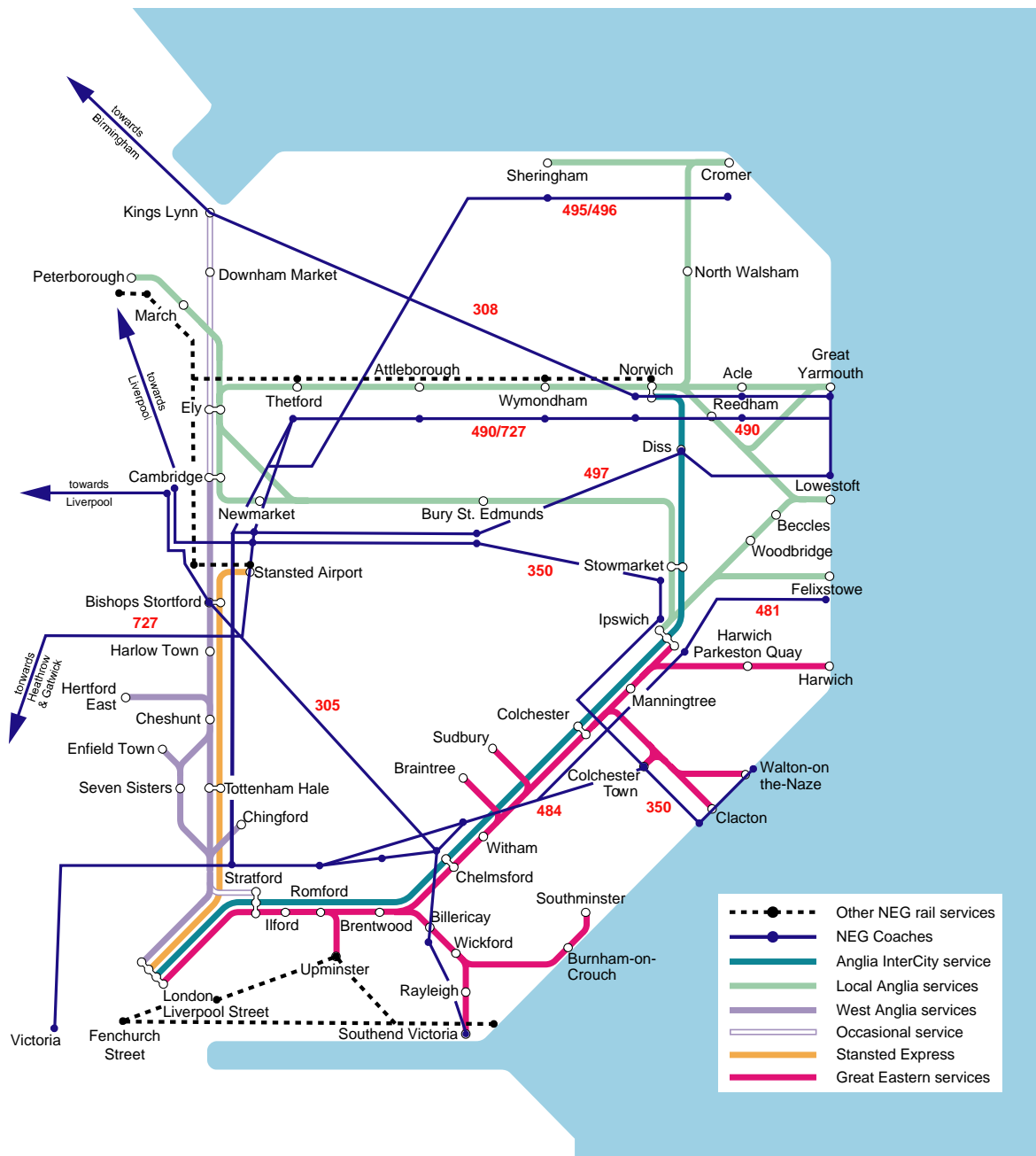


- Greater Anglia line
- c2c line

Source: CC study.

FIGURE 2

Greater Anglia rail franchise map



Source: CC study.

2.4 The financial performance of c2c and WAGN, the two NEG TOCs prior to the acquisition that are most relevant to the merger, is shown in Appendix B; turnover of c2c in the year ended 31 December 2003 was some £99 million, that of WAGN £253 million. As noted in Appendix B, c2c made a small operating profit in that year having made a loss in the previous year; WAGN a more significant operating profit in both years. A significant part (about 20 per cent) of c2c's income is revenue grant, which also accounted for a somewhat lesser proportion of WAGN income.

NEG coach operations

- 2.5 NEG's scheduled coach operations are carried out through its subsidiary National Express Limited (NEL). As shown in Appendix B, based on draft accounts NEL had a turnover of some £129 million in the year ended 31 December 2003.
- 2.6 NEL estimated that it accounted for about one-half of passenger journeys undertaken on scheduled coach services in the UK, but with direct competition on only a small number of its routes.
- 2.7 Generally, NEL does not operate or own coaches itself, but contracts with individual coach operators to provide coaches and crew. However, it bears the full risk of fluctuations in revenue of the services and maintains control of all strategic elements of the business, including establishing timetables, setting fares and determining fare structures, determining and monitoring quality standards, and marketing and promotion.
- 2.8 As discussed in paragraphs 6.2 to 6.14 and Appendix F, NEL operates ten coach routes serving the Greater Anglia area and which are relevant to our assessment of the merger.³ As shown in Figure 2, these include six services between a number of destinations in the Greater Anglia area and London; one between the Greater Anglia area and Stansted, Heathrow and Gatwick; and three between the Greater Anglia area and other regions of the UK. The total revenue of those ten services in the year ended 31 December 2003 was below £10 million (£[X]).

The Greater Anglia franchise

- 2.9 The Greater Anglia franchise comprises three previous franchises.
- (a) Anglia, formerly controlled by GB Railways, which towards the end of its franchise period was acquired by FirstGroup PLC (FirstGroup);
 - (b) Great Eastern, previously controlled by FirstGroup; and
 - (c) West Anglia, formerly part of the WAGN (West Anglia and Great Northern) franchise, operated by NEG. WAGN services from Kings Cross remain (for now) a separate franchise.

The operations of the Greater Anglia franchise have now been branded as 'one'.⁴ (The former Anglia and Great Eastern parts of the franchise are, on occasion, also referred to as one Anglia and one Great Eastern.)

- 2.10 The Greater Anglia franchise is also shown on Figure 2, which shows separately the former Anglia network (comprising both Intercity routes and a local rail network in East Anglia); the former Great Eastern network; and those parts of the WAGN network including the Stansted Express service, which are now part of Greater Anglia.
- 2.11 Since the Greater Anglia franchise has only recently started operation, information is only available on the financial performance of its component parts. As shown in Appendix B, total turnover of the TOCs currently constituting the Greater Anglia franchise was about £[X] million in 2003, with a positive operating profit of

³It also operates a number of routes in those parts of the Greater Anglia area (to and from Stansted and Cambridge) where its subsidiary WAGN operated prior to the merger, and which are not therefore affected by the merger.

⁴There have also been some changes in responsibility for a number of stations between Peterborough and Norwich which were previously part of Central Trains franchise, and reallocation of services to some stations in that part of the area.

£[~~3~~] million. Turnover of Anglia Railways was some £69 million in 2003, and Great Eastern £188 million; Anglia Railways made a very small loss in that year and Great Eastern an operating profit. (Appendix B also gives information for the West Anglia part of WAGN, also now part of Greater Anglia.) Both the former Anglia and Great Eastern franchises have been unusual in that the previous successful bids required a revenue payment by the franchisee, rather than subsidies.

- 2.12 In announcing the award of the new Greater Anglia franchise to NEG, the Strategic Rail Authority (SRA)⁵ stated that the future value of total franchise premium receipts to the SRA was in excess of £0.5 billion, but this was subject to finalization of revised track access charges.
- 2.13 The amalgamation of franchises that has resulted in the creation of the Greater Anglia franchise was part of a policy of having only one operator from the main London termini, in this case Liverpool Street. The benefits claimed for that policy by the SRA were that:
- (a) A single operator would facilitate optimum use of available capacity both in the station and on the approaches to the station.
 - (b) A single operator would provide a simplified, more understandable and impartial day to day interface with the passenger.
 - (c) A single operator would remove many contractual interfaces at stations and simplify the timetable planning process.
 - (d) A single operator would improve reaction to service disruptions.
 - (e) A single operator should be able to exploit improved economies of scale.
- 2.14 SRA recognized that such franchises would not be able to capture any possible future advantages of rail-on-rail competition. Whilst this was a potential disadvantage, the SRA believed that it was a relatively low probability as there was very little spare capacity at Liverpool Street and the degree of competition between Anglia and First Great Eastern had led to some increased risks to its budgets. Much spare track capacity had been consumed since 1995/96, limiting the scope for extending direct competition. Moreover, the SRA believed that the operational advantages, referred to in paragraph 2.13, to be achieved by adopting the proposed approach far outweighed such possible disadvantage.
- 2.15 The SRA said that it sought to ensure competition for the market, by maximizing competition for the franchise on offer, and specifying in the franchise agreement what it wanted delivered for passenger services. Competition within the rail industry was thus fostered within the system—ie, by competition for the market; there were few opportunities for competition in the market, very largely because of the constraint on network availability and the risks to its budget.
- 2.16 The Office of the Rail Regulator (ORR) also told us that the main arena for competition for rail services was the bidding process for franchise awards. A limited degree of on-track competition occurred where an open access passenger operator⁶ provided overlapping services. A certain level of competition also occurred where

⁵During the course of our inquiry, the Government issued a White Paper on 'The Future of Rail' proposing that the SRA be wound up, and its strategic responsibilities and financial obligations pass to the Secretary of State. References to the SRA in this report include its successor body.

⁶Under an agreement which allows an operator other than a franchisee or franchise operator to provide passenger rail services where a franchised operator also provides service.

rival operators operated services along the same route or to the same origin/destination points, sometimes by different routes. This latter form of competition often involved a trade-off between cost and journey time/comfort (for example, London–Birmingham and London–Exeter and, we noted, London–Gatwick over the same route); and to competing operators' ability to offer lower, unregulated fares dedicated to their own services.

- 2.17 The creation of the Greater Anglia franchise, including combining within one franchise the services previously operated by two separate franchisees between Liverpool Street and Ipswich, is not in itself part of the merger situation referred to the CC, and it is therefore outside the scope of this inquiry.

3. The merger

- 3.1 The formation of the Greater Anglia franchise was first announced in 2002. The pre-qualification stage started in March 2002, and in May 2002 it was announced that nine companies had 'pre-qualified' to be considered. These included (as well as NEG itself) GB Railways Group, then the incumbent operator of the Anglia franchise, and FirstGroup (then the incumbent operator of the Great Eastern franchise). Other companies pre-qualifying were Arriva, Connex Rail Limited, GNER Holdings Ltd (a subsidiary of Sea Containers Ltd), The GOVIA Limited (in which the Go-Ahead Group plc had an interest), NS Dutch Railways and Virgin Trains. In April 2003 three of these pre-qualified bidders were short-listed for the franchise: Arriva, GB Railways⁷ and NEG. NEG was declared preferred bidder for the franchise on 22 December 2003; and started operating the franchise on 1 April 2004.
- 3.2 The Greater Anglia franchise is for seven years, but with an additional three years at NEG's option subject to it meeting specified performance criteria within the original term.
- 3.3 Three aspects of the franchise in particular could be material in assessing the effects of the merger. They are:
- the treatment of revenue risk;
 - the extent of control over fares; and
 - the extent of control over non-price factors.

Revenue risk

- 3.4 Various arrangements have been adopted by the TOCs and the SRA for 'revenue risk'—ie the sharing of passenger revenues, and hence sharing the risk of revenues being more or less than expected—of rail franchises or parts of them. Previously, in most rail franchises, all revenue risk was borne by the franchisee: ie, all revenue went to the franchisee and the franchisee paid a fixed sum to the SRA (or received a fixed subsidy from the SRA) for running the franchise. The c2c franchise remains on this basis. In practice, however, a number of franchisees then required additional subsidy from SRA, often due to their initial bids having been over-optimistic (particularly in relation to forecast operational cost savings) or their operations having been affected by the disruption to rail services following, for example, the Hatfield accident. At the other extreme, in some of the areas in which Passenger Transport

⁷GB Railways was subsequently acquired by FirstGroup, FirstGroup itself having not been shortlisted for the franchise.

Executives (PTEs) retained an interest, all the revenue risk was borne by the PTEs which also specified the service levels: ie, all passenger revenue in effect went to the PTE, and the franchisee was paid a fixed sum for operating the franchise. More recently, a hybrid 'cap and collar' system (see Appendix C) has been adopted for the Greater Anglia franchise and other recent franchises, in which all passenger revenue accrues to the franchisee in a fairly narrow band around a target level of revenue; the franchisee bears only some of the revenue risk in an area around that band, and a smaller proportion of risk beyond that band.

- 3.5 The arrangements for bearing revenue risk will affect incentives for, for example, attracting passengers from coach to rail: if none of the benefit of doing so accrues to the franchisee, there is no effective incentive to attract passengers to rail, from the operators' own coach services; on the other hand, there is an incentive to do so if the franchisee bears some or all of the revenue risk.
- 3.6 As discussed in Appendix C the revenue risk under the Greater Anglia franchise agreement is shared between the SRA and the franchisee in a 'cap and collar' type of approach. The mechanism incorporates a target level of passenger revenue, with a threshold level of revenue above that target, and a percentage for sharing any additional revenue above that threshold. There are also two threshold levels of revenue below the target, with two percentages for providing revenue support (from the fifth year onwards) the first between these two support levels, and the second below the lower support level. In the event that the SRA alters the service specification with an impact on the revenue, the value of predicted revenue used above is rebased to take account of the service alteration. There are other provisions to ensure that the franchisee does not suffer or benefit from the effects of changes subsequently required by the SRA.

Control over fares

- 3.7 As discussed in Appendix C, regulated fares are generally confined to 'saver' return fares (or standard return fares if there were no saver returns in 1995, as for shorter journeys); weekly season tickets; and most commuter fares in and around London.⁸ The most important category of non-regulated fares in the London suburban area are cheap day return tickets mainly used by leisure passengers.
- 3.8 The impact of regulation varies between franchises. NEG told us that regulated fares accounted in 2002/03 for a substantial majority of First Great Eastern and c2c revenue (79 per cent and [X] per cent respectively), and a sizeable minority (32 per cent) of Anglia Railways revenue. Non-regulated fares may, however, be constrained by the level of regulated fares to the extent that passengers can switch between different types of fare if the relative fare levels go up or down. The SRA, for example, told us that the price of cheap day return tickets is significantly constrained by off-peak travelcards for travel within London, the price of which is set centrally by Transport for London (TfL) and the Association of Train Operating Companies; there is also significant cross-elasticity between full and reduced fares.
- 3.9 The SRA has recently reviewed its fares policy and relaxed the cap on allowed price increases from RPI-1 to RPI+1. It is also reviewing whether to change the regime for the current regulation of saver return fares. One reason for the latter is its view that over the longer distances involved 'train operators generally face a competitive mar-

⁸In the case of London commuter fares, for example, an overall limit is applied to a basket of fares (limiting the average increase of that fares basket to 1 per cent a year above the RPI, often expressed as RPI+1), but with increases in individual fares within the basket restricted to RPI+6. All other regulated fares are in a separate basket which is subject to the same restriction.

ket for this type of travel because passengers can normally choose alternative forms of travel [by which it meant coach or air travel] if operators do not offer attractive and affordable fares'.⁹ However, its policy on such fares is as yet not finalized. The outcome of this review is expected by March 2006. Its policy is in any case subject to approval by Ministers.

Control over non-price factors

- 3.10 The Greater Anglia franchise has been described by the SRA as the first 'new style passenger train franchise', setting clearer requirements for the services to be delivered under new service quality standards. As discussed in Appendix C, this includes a more prescriptive output specification, including the detailed services and length of trains to be operated, and a system of bonuses and penalties relating to various service standards.

NEG's plans for operating the franchises

- 3.11 Greater Anglia and c2c are operated by separate subsidiaries of NEG, as is NEL, its coach operation. NEG told us there were no plans to integrate the Greater Anglia franchise with any other NEG subsidiaries; it was a requirement of the SRA that the franchise be managed separately from NEG's other businesses and this was in any event consistent with NEG's policy of devolved management.
- 3.12 We have noted that c2c is currently part of 'Londonlines', which also include the Silverlink and remaining part of the WAGN franchises, with which it shares some overheads. The NEG trains division strategy plan referred to the risk of it losing the other two franchises within the next two years, leaving c2c alone to bear the current overheads (although the Silverlink franchise was subsequently extended for two years). The plan also refers to NEG's commitment to the SRA to keep the TOCs self-sufficient, but aims to identify further synergy opportunities in such an event, perhaps by integrating c2c into 'one'. We were told that any such integration would require SRA consent, as was the case for Londonlines.
- 3.13 The White Paper on The Future of Rail (see footnote to paragraph 2.12) referred to the Government's intention to reduce the number of franchises and align their boundaries with Network Rail operational areas. NEG told us that it would be consistent with this for the Government to fold c2c into Greater Anglia, both being within the same Network Rail management unit (as are the Metro services of Silverlink, also operated by NEG).

Jurisdiction

- 3.14 In order to decide whether a relevant merger situation has been created under Part 3 of the Act, we are required to consider first, whether two or more enterprises have ceased to be distinct within the meaning of the Act and, second, whether either the turnover test in the Act (namely whether the value of the turnover in the UK of the enterprise being taken over exceeds £70 million), or the share of supply test (ie whether the merger creates or enhances a share of supply of more than 25 per cent of goods or services of any description in the UK or any substantial part of the UK) is satisfied.

⁹SRA, Fares Review Conclusions 2003, June 2003, Section 2.1.

- 3.15 As regards the first question, section 66(3) of the Railways Act 1993 (as amended by paragraph 30(8) of Schedule 25 to the Act), provides that where a person enters into a franchise agreement as a franchisee there shall be taken to be brought under his control an enterprise engaged in supplying the railway services to which the agreement relates. The award of a rail franchise therefore (other than to an existing operator of that franchise) constitutes an acquisition of control leading to two or more enterprises ceasing to be distinct for the purpose of section 23(1) of the Act. As regards the second question, as is apparent from Appendix B (Table 7) the current turnover derived from the Greater Anglia franchise significantly exceeds £70 million. We therefore conclude that a relevant merger situation has been created.
- 3.16 The merger may affect the following overlaps between the services of the Greater Anglia franchise and of NEG:
- (a) between NEL's coach services and Greater Anglia rail services on a number of routes in the Greater Anglia area, in particular between the Greater Anglia area and London;
 - (b) between Central Train rail services between Peterborough and Norwich, and Greater Anglia rail services also on those routes; and
 - (c) between the c2c rail services between London Fenchurch Street and Southend and the Greater Anglia rail services between London Liverpool Street and Southend.
- 3.17 As discussed in Appendix D, the CC has previously examined three other acquisitions by NEG of TOCs, each involving consideration of the effect on competition between its rail and coach services.¹⁰ The effects of such mergers depend, however, on the circumstances of each case, and we have examined the current merger taking into account the nature of the services affected in and evidence relevant to this case. The CC has not previously examined the effect of any merger on competition between rail operators.

4. Market definition

- 4.1 In the terms of reference, the OFT said that it believed it is or may be the case that the merger situation 'has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services, namely the supply of passenger transport services on point-to-point routes in the Greater Anglia area' (ie routes between particular places at which passengers start or finish their journeys on a train or coach). However, the terms of reference require us to consider whether the merger situation may be expected to result in a substantial lessening of competition within any market or markets within the UK, and in doing that we are not confined to those markets specified by the OFT.
- 4.2 In defining markets, one tool that we have regard to is the 'hypothetical monopolist test'.¹¹ This test entails asking whether it would be profitable for a hypothetical monopoly supplier of a particular product or service to introduce a small but significant non-transitory increase in price (SSNIP). This will depend on the extent to which customers would reduce usage in response to such a price change and whether

¹⁰*National Express Group PLC and Midland Main Line Limited: a report on the merger situation*, The Stationery Office, Cm 3495, December 1996 (the MML report); *National Express Group PLC and ScotRail Railways Limited, a report on the merger situation*, HMSO, December 1997, Cm 3773 (the NEG:ScotRail report); and *National Express Group PLC and Central Trains Limited, a report on the merger situation*, HMSO, December 1997, Cm 3774 (the Central Trains report).

¹¹More detail on the way the CC applies this can be found in the CC's *Guidelines on Merger References (CC2)*.

therefore there would be increased or decreased revenue as a result of a price change.¹² But it also depends on whether the reduction in output would reduce costs. If so, even if revenue were reduced, a price increase could nonetheless be profitable. If such a price increase were profitable and could be sustained, that product or service in question could be regarded as being monopolizable, and would therefore be considered a separate market.

Point-to-point flows

- 4.3 Passengers' demand is to travel from their particular origin to their particular destination. The coach stops and rail stations they use may, however, be some distance away from the passengers' ultimate origins and destinations. NEG and SRA told us that about 50 per cent of passengers using the c2c and Greater Anglia rail services between London and Southend walk to the stations they use. The survey we carried out suggested that less than 20 per cent of passengers on the main rail and coach flows between London and Norwich, Ipswich and Colchester walk to the stations or coach stops they use. Other passengers travel predominantly by car or bus potentially over much longer distances to access stations or coach stops. The catchment areas—the areas over which passengers travel to railway stations or coach stops—can therefore be wide, depending on the options available to passengers. The origins and destinations of users may also potentially be served by a number of stations or coach stops. Hence relevant markets can best be expressed with reference to point-to-point journeys (in principle each point-to-point journey is a separate market).

Substitutability between different modes on point-to-point journeys

- 4.4 A number of different transport services may compete for business on such point-to-point journeys. As the CC noted in the FirstGroup:ScotRail report,¹³ passenger choice between modes of travel is likely to depend on a number of aspects of the journey, including the cost of the journey, the journey time (including the time spent travelling between the passengers' origin and destination to and from the stations or bus/coach stops), frequency of services, and whether direct services are available. These factors, which also apply to this inquiry, are sometimes included in a wider measure of 'generalized cost'¹⁴ of a journey, including a passenger's valuation of the time spent travelling.
- 4.5 As the CC noted in the recent FirstGroup:ScotRail report, there is an extensive and complex array of evidence available on the demand for different modes of transport used for such point-to-point journeys: see Appendix E. The evidence we have seen suggests that there is limited substitutability between public and private transport in response to price changes. However, the extent of substitutability between public and private transport may vary. In particular private transport accounts for a relatively small share of journeys into central London, the flows with which we are primarily concerned here, but a much higher share of journeys in other urban or rural areas. This reflects the disadvantages of driving into central London including traffic congestion, the cost of the congestion charge and the lack of car parking or its cost.

¹²If elasticity is greater in absolute value than -1 , the per cent reduction in usage would be greater than the per cent increase in prices and revenue would fall.

¹³*FirstGroup plc and the Scottish Passenger Rail franchise: A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited.* June 2004.

¹⁴Generalized cost includes in-vehicle time; the time spent travelling between the stops/stations at each end of the journey, and any additional cost in doing so (eg on fares); any 'interchange penalty' reflecting the need to change services or modes to complete a journey; the fare paid for the journey; and sometimes other aspects of the journey such as convenience, reliability or 'image' of the mode of transport used.

- 4.6 We consider in section 6 the extent of substitutability between coach and rail for the point-to-point journeys where the coach and rail services we are considering overlap. As we note below, the coach services we are considering generally offer significantly lower fares than rail, but significantly longer journey times and lower frequency. For some passengers, particularly those commuting or on business, the disadvantage of longer journey times by coach would be significantly greater than the advantage of lower fares; for others, particularly those travelling for leisure or on relatively low incomes, the longer journey time would be justified by the fare savings offered. However, for those passengers wanting to travel beyond London, for which no direct coach or rail services are available, coach may offer more convenient interchange facilities, avoiding the need to travel between different London termini. Furthermore, for passengers travelling to airports, coach may also offer the only direct services.
- 4.7 In section 7 we consider the substitutability between the different rail services between Peterborough, Cambridge and Norwich, and between London and Southend. As we note below, the main reason passengers choose their existing line is its greater accessibility to their origins and destinations.

Segments of the passenger transport market

- 4.8 There are also significant differences in the characteristics of users and their ability to use alternative modes of transport. In particular (as was also the case in the MML report—see footnote to paragraph 3.17), the coach routes we are considering are used predominantly by leisure passengers, since the longer journey times discourage their use for commuting or business purposes: rail services on the other hand, are used for all such journey purposes. It is therefore appropriate to distinguish different segments within the relevant public transport markets, in particular between commuting, business and leisure travel.

Possible network markets

- 4.9 In considering point-to-point public transport journeys as a relevant market we need to consider the routes which serve them. But in the FirstGroup:ScotRail report, the CC identified the existence of wider public transport network markets.¹⁵
- (a) Firstly this was because of the role of the public sector in supporting rail and, in that case, local bus services, and in evaluating the appropriate balance between the two. In the current case, however, there is no public sector support for coach services.¹⁶
- (b) But secondly in that case, the CC considered wider networks as of relevance to the operators of the services, for example allowing them to allocate resources between individual routes, and to offer network tickets to passengers. Such network tickets can be to the competitive advantage of established operators and the disadvantage of other operators. In particular, it is difficult for new entrants to operate on a network basis. The CC also considered networks to be relevant to passengers, who benefited from the availability of such network tickets.

¹⁵As we said in that report, a network (a collection of interconnected services) could be defined in relation to a particular operator's services or a wider geographical area.

¹⁶Other than Bus Service Operators Grant on sections registered as local bus services or granted a London service permit by TfL and grants in support of concessionary fares.

- 4.10 Such network advantages arise to some extent in this inquiry—a sizeable minority (about [§] per cent) of NEL passengers on some of the routes the CC are considering (and significantly more on other routes) change between coach services at Victoria Coach Station.¹⁷ Hence the scope of NEL’s network is of value to its passengers. But it is also of competitive benefit to NEL, since other competitors or new entrants are not in a position to develop similar networks. The value of individual routes to NEL’s wider network is therefore relevant in our consideration of the effect of the merger on individual routes. However, that wider network is not affected by the merger. Network benefits to rail passengers, on the other hand, are less dependent on the operator, than on the terms of the franchise which require participation in, for example, national ticketing and network card arrangements.
- 4.11 On balance, therefore, there is less need to consider markets on a network basis in the current case than in cases involving local bus:rail overlaps.

Conclusion on market definition

4.12 We therefore conclude:

- it is appropriate to consider point-to-point journeys as relevant markets;
- public transport journeys are different from journeys by private transport on the routes which are the principal concern to us;
- it is also appropriate to distinguish leisure travel from commuting and business travel; and
- we see no need in this case to consider markets on a network basis.

5. The counterfactual

- 5.1 In considering the counterfactual of what might happen in the absence of the merger, the CC would normally look at the position before the merger. In this case, three former franchises have been amalgamated into one, but this is not part of the terms of reference since it would have occurred regardless of who won the franchise. The position prior to the merger could not therefore be assumed to have carried on, since FirstGroup, the existing operator of most of the services, was only one of nine bidders for the franchise. Of the nine bidders, the three that we ought to consider with regard to the counterfactual are the shortlisted bidders—FirstGroup, Arriva and NEG.
- 5.2 The particular overlaps that arise from the merger—between NEG’s rail and coach operation, and between its separate rail operations—would not have arisen in the case of any other successful bidder. NEG, however, argued that the award of the Greater Anglia franchise to NEG would nonetheless create new competition—between bus and rail services—within a significant part of the region which would not have occurred had it been awarded to other likely winners.
- 5.3 Of the nine companies regarded by the SRA as ‘pre-qualified’ to be considered for the franchise, we are aware of possible competition considerations only in the cases of the three short-listed bidders: NEG, for its coach:rail overlaps and rail:rail overlaps which we are currently considering; FirstGroup; and Arriva.

¹⁷We noted in the MML report that about 30 per cent of NEL coach passengers changed coaches during their journey.

- 5.4 FirstGroup operates extensive local and express bus services in the Greater Anglia area, many of which overlap with the Greater Anglia rail services. Many of the overlaps would be with the former Great Eastern services. However, FirstGroup was itself already the operator of those Great Eastern services. There would be many other overlaps between FirstGroup bus services and the Anglia services. But these rail services were previously operated by GB Railways, which was subsequently acquired by FirstGroup. The OFT did not refer that acquisition to the CC. Very few additional overlaps would have arisen had FirstGroup been awarded the franchise (these would have resulted from its acquiring those parts of the former WAGN operations which are now part of Greater Anglia).
- 5.5 Arriva operates local bus services in north-east London and south-west Essex, a much smaller part of the Greater Anglia area than First Group's operation. Overlaps between Greater Anglia and Arriva would be much more limited than in the case of FirstGroup and even less likely to affect competition.
- 5.6 In our view, therefore, and given in particular that FirstGroup's previous operation of bus and rail services in this area had not been regarded as of concern by the OFT, we think that it is unlikely that any other competition concerns would have arisen had the franchise been awarded to any other bidder.
- 5.7 NEG also argued that the success in bidding for the franchise indicated that other bidders would have offered inferior terms, with fewer customer benefits, both in the sense of benefits to passengers and to the SRA. In our view, any such customer benefits would only be relevant in the context of any remedies to be considered.

6. Assessment of competitive effects of the merger on competition between coach and rail in Greater Anglia

- 6.1 In assessing the effect of the merger on competition between coach and rail, we consider:
- the extent of overlap between coach and rail services in the Greater Anglia area;
 - the effect of the merger on market shares;
 - the extent of substitutability between coach and rail services on these overlap flows;
 - the effect of the merger on coach services in the Greater Anglia area; and
 - the effect of the merger on rail services in the Greater Anglia area.

Extent of overlap between coach and rail

- 6.2 The OFT decision document referred to 52 overlaps between NEG's coach and rail services that would be affected by the merger. During the course of our inquiry, NEG identified some 64 flows on ten coach routes¹⁸ where as a result of the merger coach services overlap with the Greater Anglia franchise services. At the request of the OFT, NEG had confined such overlap flows to those having direct rail connections. However, on some of these ten routes that we have considered, there are also overlap flows between the direct services offered by coach and indirect services

¹⁸We have treated the 495 and 496 as separate routes for this purpose.

available by rail, but generally with timetabled connections between them¹⁹ and shorter overall journey times. The four main additional overlap flows²⁰ are on the 495/496 between Cromer and London, and between Sheringham and London (for which rail travel requires changing train at Norwich); on the 497 between Newmarket and London (which would require changing trains at Cambridge); and on the 481 between Felixstowe and London (requiring a change of train at Ipswich).

6.3 The 727 service between Norwich, Heathrow and Gatwick (for which some very minor overlap flows with direct rail services had been identified) could also be regarded as offering an alternative to travelling to the airport by an indirect rail journey, ie by train to Liverpool Street, and then by taxi, underground or rail to the airports. We also therefore considered the two additional overlap flows between Norwich and Heathrow, and between Norwich and Gatwick.

6.4 As discussed in Appendix F, in assessing which of these 71 overlap flows and ten routes are of possible concern, we took into account the following factors:

(a) Some of the overlap flows identified by the OFT are very minor; on some indeed there are no coach passengers. In the Central Trains report (see footnote to paragraph 3.17), the CC regarded overlaps between coach and rail as significant only if they accounted for annual coach revenues of more than £20,000 a year, and a frequency of three services a day in summer, but we have also considered the implications of lower criteria both for revenue (of £10,000 a year) and of two services a day. Only 20 overlap flows on eight routes²¹ have coach revenues of over £10,000 a year.

(b) If overlap flows account for a small percentage of the revenue on a route, there may be little scope to reduce service or substantially to increase fares without putting at risk the remaining revenues on that route. In the recent FirstGroup: ScotRail report, involving overlap between rail and bus services, the CC considered there would be a substantial lessening of competition only if, as a result of the merger, overlaps flows not subject to effective competition would account for more than 10 per cent of revenues on a route.²² On one of the eight routes,²³ although there are two overlap flows with revenue of over £10,000, the total revenue from overlap flows is below 10 per cent of total route revenue, and we excluded them from further analysis.

6.5 There are therefore seven coach routes, accounting for 18 overlap flows²⁴ which could give rise to possible concern. These are summarized in Table 1. Each of the overlap flows has revenue of more than £10,000, as shown in Appendix F, and on each of these routes total overlap flows account for more than 10 per cent of revenue on the routes. Of the flows into London, the most significant overlap flow, by some margin, in terms of coach revenue is that between Norwich and London.

¹⁹As printed in the national and other timetables: but with no guaranteed connection between them.

²⁰There is a further smaller overlap flow with indirect rail services between Cambridge and Colchester.

²¹There are no such overlaps on the 305 and 308 between Clacton and Liverpool, and between Great Yarmouth and Birmingham.

²²In that report, we considered not only overlap flows where the railway station and bus stop were located close to each other, but also potential overlap flows where bus and rail could compete over wider catchment areas, were the bus services, which currently operate from the areas at some distance from the local stations direct into the respective city centres, instead reconfigured to operate as feeder services into those stations. In the current case, rail and coach both serve wide catchment areas.

²³The 350.

²⁴Table 1 shows 19 flows, because the Great Yarmouth—London flow, being served by two routes, is shown twice.

TABLE 1 Coach routes and flows where main overlaps with rail result

<i>Route</i>	<i>All overlaps as % revenue</i>	<i>Main overlap flows</i>
481: Felixstowe/Ipswich-London	96	Felixstowe-London* Ipswich-London Chelmsford-London
484: Clacton-London	77	Colchester-London Clacton-London Clacton-Stratford Clacton-Romford
490: Great Yarmouth/Norwich-London	77	Norwich-London Great Yarmouth-London Norwich-Stratford
495/6: Cromer-London	15	Sheringham-London* Cromer-London*
497: Great Yarmouth-London	81	Great Yarmouth-London Lowestoft-London Diss-London Bury St Edmunds-London* Newmarket-London*
727: Norwich-London	19	Norwich-Gatwick*† Norwich-Heathrow*†

Source: CC study from information supplied by NEG.

*Indirect rail flows.

†Partial overlaps only—rail journey involves significant elements outside the reference area.

6.6 Of these routes, NEG told us that the bulk of passengers using the Norwich to Heathrow and Gatwick service were travelling between the London airports themselves; as shown in Table 1 the overlap flows from Norwich to the two airports account for less than 20 per cent of the revenues on the service. As noted above, for journeys between Norwich and the two airports, coach has some advantages compared with rail. The direct coach services avoid the need to change twice (usually with baggage) in travelling beyond Liverpool Street to Heathrow or Gatwick, with less certainty as to the connection that can be made and to the total travelling time. These coach services also have a higher frequency (two-hourly) and journey times more comparable with rail than is the case with the other coach routes set out in Table 1. In contrast to journeys into London, moreover, use of car accounts for a substantial amount of travel between the Greater Anglia area and the two airports, but with use of coach enabling passengers to save on the cost of airport car parking.

6.7 Excluding the airport services, we have therefore focused on 16 overlap flows on six coach routes (the 481, 484, 490, 495/6 and 497) which give rise to concern. Table 2 compares the coach and rail services operated on the overlap flows of concern identified on those routes.

TABLE 2 Main overlap flows

Service No	Overlap	Journey time (mins)		Frequency (Mon-Fri)		Off-peak period return fares (£)	
		Coach	Rail	Coach	Rail	Coach*	Rail†
481	Felixstowe—London	160–235	100	2 per day	Hourly§	16.50	26.50
481	Ipswich—London	160–180	70	3 per day	4 per hour	15.50	23.60
481	Chelmsford—London	100–120	35	3 per day	5 per hour	9.75	14.80
484	Clacton—London	170–190	85	3 per day	Hourly	15.50	29.30
484	Colchester—London	120–160	50–60	2/3 per day	6 per hour	13.0	22.20
484	Clacton—Stratford‡	135–150	80	3 per day	Hourly	15.50	22.30**
484	Clacton—Romford	105	80	3 per day	2 per day	15.50	21.70**
490	Norwich—London	185–210	105–120	5 per day	2 per hour	20.50	32.60
490	Norwich—Stratford‡	140	100	5 per day	Hourly	20.50	32.20
490/497	Great Yarmouth—London‡	190	150	3 per day	2 per day¶	20.50	33.80
495/6	Cromer—London	255–265	150–180	2 per day	Hourly§	22.00	35.00
495/6	Sheringham—London	250	190	2 per day	Hourly§	22.00	35.00
497	Lowestoft—London‡	245–270	165	2 per day	1 per day¶	20.50	32.60
497	Diss—London	190	90	2 per day	Hourly	19.50	29.50
497	Bury St Edmunds—London	130–145	105–120	2 per day	1 per day¶	16.50	28.90
497	Newmarket—London	110–125	80–100	2 per day	Hourly§	16.50	25.40

Source: CC study.

*Fares quoted are for off-peak days of the week: on-peak days they are between £2 and £3.50 higher.

†Saver return except ** which are Network Away Break.

‡See paragraph 6.13.

§Only indirect services available (other than one direct service a day between Bury St Edmunds and London).

¶Indirect services also available, more frequent than coach services.

Effect of merger on market shares

6.8 As shown in Table 8 of Appendix F, the share of passengers accounted for by coach travel on these flows is generally very limited. On 12 flows the share is below some 15 per cent: below [X] per cent in the case of five flows; [X] per cent between London and Norwich which has the largest number of coach passengers; and between [X] per cent in the case of six other flows. Four of these latter flows, however have only a very small number (about [X]) of coach passengers a year. Coach accounts for a sizeable minority of passengers on three flows where it mainly competes with indirect rail services, but on two of which there are again only a very small number of passengers. On the final flow, Norwich—Stratford, coach has the majority of a very small number of passengers. NEG argued that market shares to Stratford were likely to reflect passengers choosing to leave the coach at Stratford to continue to Central London by underground, in order to save on the lengthy journey time by coach to Victoria Coach Station.²⁵

6.9 On average, coach accounts for a very small share—about 2 per cent—of the total number of passengers travelling by coach and rail on the flows identified in Table 2. There are, however, no other operators of coach or rail services on these flows; hence NEG would be the only operator of public transport services on those flows.

²⁵As noted in Appendix F, moreover, train services between London and Norwich also stop at Stratford only on journeys toward London.

- 6.10 The share of coach travel is significantly below that in other inquiries (in the MML report, for example, coach accounted for on average 12 per cent of total passenger numbers between London and the five main destinations served). The level of frequencies is also below that of most of the services in previous CC inquiries.
- 6.11 NEG accepted that some coach services could be regarded as competing with rail services but argued that this would vary between routes. In the case of the Greater Anglia area it believed competition was at most very limited, as shown by the low frequencies and small number of passengers carried on the coach services. It attributed the poor performance of coach services in the area to the relatively poor road network in the area.
- 6.12 The coach services we are considering serve predominantly leisure passengers. Very few of the services, for example, arrive in London in the morning peak periods, and are not therefore likely to be used for commuting; the lengthy journey times (for the reasons given in the previous paragraph) would also preclude their use for commuting or most business purposes. We have not seen precise figures for the percentage of traffic on individual rail services by journey purpose. As noted in Appendix F, we saw estimates by NEG that the proportion of leisure rail passengers on Greater Anglia rail services increases with distance, from about 20 per cent for commuter services to about 40 per cent of InterCity passengers. (For rural services, the percentage is higher still, some 60 per cent).
- 6.13 Table 10 of Appendix F shows the coach share of leisure travel to these destinations on the assumption that 40 per cent of rail passengers on the routes listed in Table 2 are travelling for leisure purposes. On 12 overlap flows, the coach share of leisure passengers would remain below some 30 per cent. This includes the two main overlap flows in terms of total public transport passengers—Colchester and Chelmsford—London—where the very small coach share of the leisure market, of [X] per cent or below, itself suggests the degree of competition from coach to rail on such overlap flows is likely to be very limited. The coach share of leisure passengers would also be very limited, below [X] per cent, on three other overlap flows, and some [X] per cent between London and Norwich. The coach share of leisure passengers would be highest, about [X] per cent or above, on three overlap flows where coach mainly competes with indirect rail services and on the Norwich—Stratford overlap flow referred to above. NEG, however, believed that some rail passengers tended to drive some distance to use a station with the best services (and parking): hence, rail leisure passengers living in the Eastern Broads area were as likely to enter the public transport system at Norwich or at Great Yarmouth, whereas coach leisure passengers from the same area were more likely to do so at Great Yarmouth. This could apply to other flows operated by indirect rail services.
- 6.14 In general, therefore, the coach services about which we are concerned serve predominately leisure passengers; but the low coach share of leisure passengers on many of these overlap flows suggests competition between coach and rail is likely to be limited.

Extent of substitutability between coach and rail

- 6.15 The different characteristics of coach and rail services are shown in Table 2. Coach services generally offer significantly lower fares. The fares shown in Table 2 are, however, among a wide range of fares available. For example, a super advance return rail fare of £20 is currently available from Norwich—London; as is a coach economy APEX return fare, also requiring advance booking, of £17. Discounted fares are also available on both rail and coach. However, discount rail fares generally

require purchase of a railcard (for example, for senior citizens and students); whereas about one-third of coach passengers benefit from concessionary fares at half of the standard price for passengers of over 60 and disabled passengers, financed by government. Coach 'fun fares' of as low as £1 are also available for booking over the Internet, but these are usually linked to a small number of seats per service.

- 6.16 Against the advantages of lower fares, coach has significantly longer journey times, and much more limited frequencies. Based on responses to our survey of coach and off-peak rail passengers between London and Norwich, Ipswich and Colchester, the Institute of Transport Studies of the University of Leeds (ITS) estimated the generalized cost (see paragraph 4.4) of the coach and rail passengers on these routes, allowing for differences in journey time is set out in Table 3.

TABLE 3 Generalized costs of using coach and rail services

	£	
	<i>Coach</i>	<i>Rail</i>
<i>Off-peak generalized costs (single leg)</i>		
Norwich–London	34.39	31.68
Ipswich–London	30.03	21.44
Colchester–London	27.47	18.35

Source: ITS analysis of CC survey results.

- 6.17 Relative user costs are, therefore, significantly different from relative fares. Although coach fares are below rail fares on these services, the off-peak generalized costs to coach users are above those of train users, given the longer journey times by coach.

- 6.18 Moreover, as we noted in paragraph 4.10, a sizeable minority (some [x%] per cent) of coach passengers on most of the routes change to another service at Victoria Coach Station, and a significant majority (some [x%] per cent) in the case of the 481 and 484 services. To those passengers, coach services also offer more convenient facilities for changing to services beyond London, compared with train services which would require a bus, underground or taxi connection to other rail termini for travel beyond London.

- 6.19 We also considered other evidence on the extent to which coach and rail services could be regarded as substitutable. A number of reasons to regard coach and rail as substitutable were referred to in previous reports (see Appendix D), namely:

- (a) that a significant proportion of the increase in coach demand in response to lower prices after coach deregulation resulted from passengers switching from rail;
- (b) that in response to competition from coach travel at that time, lower fare saver and supersaver tickets were introduced for rail travel;
- (c) that coach prices had been set at a discount from rail prices (including reduction of coach fares to compete with APEX, advanced purchase tickets introduced for rail travel); and
- (d) that there was evidence from passenger surveys that relative fares were a significant factor in passenger choice between rail and coach travel.

As regards (c) NEG told us this had not been the case since around four years ago.

6.20 We also carried out a survey of coach and rail leisure passengers on the main flows between London and the Greater Anglia area to assess the extent of substitutability between coach and rail. An overview of the results of the survey is in Appendix G. The survey highlighted significant differences in the characteristics of leisure passengers using the two modes. Coach leisure passengers had household income only one-half that of rail passengers and had less access to cars as drivers; and a significantly higher proportion of coach than of rail passengers were female, students and/or retired.

6.21 The survey also showed cheaper fares to be the main reason for passengers to use coach rather than rail, but, as shown in Table 4, passengers tended to exaggerate how much higher these fares would be.

TABLE 4 **Price of current coach ticket compared with price of alternative train ticket, and expected price of a train ticket**

	£		
	<i>Price of current coach ticket (median)</i>	<i>Price of a rail saver return</i>	<i>How much rail ticket expected to cost</i>
Norwich—London	19.25	32.60	36.00
Ipswich—London	15.50	23.60	29.33
Colchester—London	14.29	22.20	26.89

Source: CC analysis of survey results.

6.22 We also asked passengers whether they would find it easy, neutral or difficult to switch; and whether they would switch in response to a price increase, and if so what price increase would be required to make them switch. A summary of their answers is shown in Table 5.

TABLE 5 **Potential switching between coach and rail**

Of the sample of coach and rail leisure passengers responding on the surveyed routes

	<i>per cent</i>	
	<i>Coach passengers</i>	<i>Train passengers</i>
Percentage who would find it easy or neutral to switch and would switch in response to:		
—a 5 percent price rise	-	0.5
—a 10 per cent price rise	0.8	1.5
Percentage who would:		
Find it easy or neutral to switch to rail or coach respectively	67	45
And would switch in response to a price increase	33	19
Median price increase required*	+39	+23

Source: CC analysis of survey results.

*The median figure is quoted for passengers due to the average being distorted by a small % of passengers quoting a very high required price increase.

6.23 As shown in Table 5, a negligible proportion of coach passengers said that they would switch in response to a small price increase.

6.24 As noted in Appendix E, we also commissioned Professor Wardman of ITS in Leeds to review existing studies that are available on the elasticity of demand of coach and rail, and on the cross elasticity of demand between them—that is, the extent to which the demand for coach services would change (eg increase) if there is a change (eg

increase) in the price of rail services. On the basis of these studies, Professor Wardman estimated an own price elasticity of demand of coach travel of -1.1 : ie a 10 per cent increase in coach fares would result in an 11 per cent reduction in demand. He estimated an equivalent rail leisure fare elasticity of between -1.25 and -1.35 . In order to estimate the cross elasticity of demand, he took into account the relative shares of coach and rail on the main overlap flows we are considering, and evidence from our survey on the extent to which passengers who ceased to travel by coach and rail as a result of increases in coach and rail fares respectively would do so by diverting to the other mode, or by ceasing to travel by public transport at all. On that basis, Professor Wardman estimated that there would be a very high cross-price elasticity of coach leisure demand with respect to rail (of up to 9 in the case of London–Colchester) but with very low cross-elasticity of rail leisure demand to coach (of less than 0.1).²⁶ But this reflects in part the much larger scale of rail travel. If, for example, some 90 per cent of leisure passengers between Norwich and London travel by rail, and only 10 per cent by coach, then, on the basis of Professor Wardman’s estimates, an increase in coach fares on the Norwich–London route of, for example, 10 per cent would result in a decline in coach passengers of some 11 per cent, some 40 per cent of whom—4.4 per cent of coach passengers—were estimated to transfer to rail. However, that would represent a very small percentage increase in rail passengers. We have taken these estimated elasticities into account in considering how NEG’s profit incentives would be affected by the merger.

- 6.25 In our view, based on the full range of evidence referred to above there is only a modest degree of substitutability for leisure passengers between coach and rail services in this case.

Effect of merger on coach services

- 6.26 As noted in Appendix H, there is no economic regulation of coach services. The merger would in principle, allow NEG to consider increasing fares on coach services, or reducing the level of coach services, given that it would now benefit from the additional rail revenues generated by passengers choosing to switch from coach to rail. (That benefit would be enhanced by the higher fares passengers would have to pay to travel by rail rather than coach.)
- 6.27 However, loss of coach passengers from increasing fares or withdrawing services would put at risk the network revenues generated on these services from passengers currently travelling to Victoria Coach Station to connect with other services. The profitability of some of the six services listed in paragraph 6.7 is already poor (as shown in Table 6 of Appendix B). NEG itself told us that it had in the past considered withdrawing the 481 and 484 services due to the low usage and their making losses, but had not done so in order to retain the revenues elsewhere in the network from passengers using the services to connect to routes beyond London (or vice versa). NEG also told us that network values on the previous MML case were relatively low, particularly in comparison with those on the principal services in this case.
- 6.28 NEG also argued that, given its approach of separately managing its rail and coach businesses, it ran its coach business without taking account of its rail businesses:

²⁶On the basis of survey results alone, further analysis by ITS suggested somewhat lower cross-elasticities than implied by existing literature but confirming coach travel is more sensitive to fare change than rail travel. The analysis also, however, suggested a much lower own-price elasticity of demand for leisure travel as a whole than the existing literature suggests. We regarded the estimates taking into account the more extensive existing literature as the more appropriate basis for our analysis below. NEG provided us with a number of comments by NERA questioning various aspects of the methodology of those analyses and suggested they may as a result understate the own price elasticity of demand, and overstate the cross-price elasticity. We are satisfied with the broad conclusions of the ITS analyses as to cross-elasticities between coach and rail.

rather its objective was to increase the number of coach passengers, from all sources. We accept it currently has no intention to coordinate the management of the two businesses in such a way as to maximize their overall profitability. But such intentions may change, and it would be surprising if the management of either business were to take no account of the implications for the other, or to appreciate commonality of interests as they arose. NEG also argued it would not want to put at risk its coach operation, which it owns for the long-term, by adopting any strategy of attempting to divert passengers from coach to rail which would only be of possible benefit for the seven- or ten-year term of the rail franchise. We noted, however, that the scale of its rail business is now considerably greater than of its coach business, as are the Greater Anglia rail services compared with the coach services in that area.

- 6.29 NEG told us that it had never increased coach fares or reduced services in consequence of its ownership of a TOC operating on a parallel rail route. It also told us that, in other instances where it operated both rail and coach services, it had not only maintained but also expanded those services, and in no circumstances had it reduced services. One example it quoted to us was between London and Stansted Airport, although we noted there is also competition from other coach operators on that route. It had also expanded services between London and East Midlands, although we noted that one other coach competitor also operates on some of those routes. (In both cases, however, NEG told us that entry by a new coach competitor had only begun after NEG itself expanded capacity.)
- 6.30 We have considered, in Appendix I, whether it would be profitable for NEG to increase fares or withdraw services on the six main routes of concern—the 481, 484, 490, 495/6 and 497. This will in particular depend on:
- (a) The extent to which passengers would switch to rail, rather than use other modes of travel (such as private cars), not travel at all, or travel to other destinations.
 - (b) The variability of rail and coach costs to passenger numbers. Given the availability of capacity on rail services that have to be operated during off-peak periods under the franchise agreement, additional off-peak rail passengers could be carried with negligible additional cost. Other than in the short term, the costs of operating coach services, on the other hand, would generally be more variable, in that the level of service could more easily be adjusted in line with demand, or, indeed, services can be withdrawn altogether.
 - (c) The revenue sharing arrangements under the ‘cap and collar’ arrangements in the franchise agreement: see paragraph 3.4.
 - (d) The extent to which NEG may lose profits on other parts of the network, from those passengers currently using the coach services we are considering to connect beyond London. We have noted above that a sizeable minority of passengers on the 490 and 497, but a significant majority on the 481 and 484 connect at Victoria Coach Station to other services. We accept that, if these routes were withdrawn, few if any of those passengers would be likely to travel by other means to Victoria Coach Station to connect to other services, given the much less convenient connections between Liverpool Street and Victoria Coach Station that they would now have to use.
 - (e) The extent to which operating costs of these connecting coach services can be adjusted in line with any reduction in passenger numbers.
 - (f) The differences between coach and rail fares.

- (g) The prospects for new entry into the services, which we discuss further below.
- 6.31 Our initial baseline set of assumptions for the main factors set out above was as follows:
- (a) On the basis of Professor Wardman's recommendation (see paragraph 6.24) a price elasticity of coach travel of -1.1 , with 40 per cent of passengers no longer using coach switching to rail.²⁷
 - (b) That coach costs on these routes would be mostly variable with the number of services operated. All routes are assumed to be withdrawn along with the associated direct costs, except for the 490 which is assumed to have a 40 per cent reduction in services (five to three a day), but only a 33 per cent fall in direct costs.
 - (c) That, given that NEG bears all revenue risk in a band around its predicted revenue and initially all revenue risk should revenue be below that band, it would assume it retains all of the additional rail revenue generated.
 - (d) That there would be no loss of revenues on connecting services.
- 6.32 On the above assumptions, Table 1 of Appendix I showed that there would be a small increase in profits (some £47,000 in total) from a 10 per cent fare increase on six routes (the 481, 484, 490, 495/6 and 497); but a more significant increase in profits (some £425,000 in total) from withdrawal of those six coach routes (Table 2 of that Appendix).
- 6.33 These results are very sensitive to a number of factors. On the following alternative set of assumptions such a strategy would not be profitable:
- (a) that NEG may well not be within the range of revenue in which under the cap and collar arrangements it bears all revenue risk. Initially it would not share the risk of revenues below those expected; but would share revenues higher than expected if above the revenue band. Subsequently it would share revenue to a varying extent were it above or below the revenue band. Given such risks, we considered an alternative assumption that NEG would retain 75 per cent of revenue from passengers switching from coach to rail;
 - (b) that NEG would also lose all network revenues, on those services with which passengers connect at Victoria Coach Station; and
 - (c) that particularly in the shorter-term, only a small element of operating costs on those connecting services, those relating to sales commissions, are likely to vary with the number of passengers transferring from the coach services we are considering. Given that passengers will transfer to a number of different connecting services across the network, the scope for cost reductions on individual connecting services would most likely be limited to sales commission.
- 6.34 As noted in Table 5 of Appendix I, on the alternative and in some respects more realistic assumptions which are listed in paragraph 6.33, there would be a significant reduction in profits (of £89,000) on those six routes if fares were to increase by 10 per cent; and an even greater reduction in profits (of about £600,000) on those

²⁷NEG suggested for illustration an alternative assumption that only 14 per cent of passengers no longer travelling by coach switched to rail. Such a figure would be significantly below the diversion rate recommended by Professor Wardman, of between 22 and 53 per cent for the three main flows, although we noted in paragraph 6.23 that our survey suggested that very few, if any passengers, would switch to rail in response to a small increase in fares.

routes if services were to be withdrawn. Even if half of operating costs on connecting services were regarded as variable with any reduction in connecting passengers, withdrawal of those services would not be profitable. As shown in Appendix I, a reduction of the London–Norwich service from five to three a day would also be unprofitable, even before taking account of the loss of network revenues.

- 6.35 Thus while our initial baseline estimates suggested that increases in coach fares or withdrawal of coach services would be profitable, on alternative and in some respects more realistic assumptions they would be unprofitable. The analysis in our view suggests that it is unlikely it would be profitable for NEG to raise fares or reduce services on those routes affected by the merger, given, in particular, the loss of network revenues from passengers connecting from these routes to other services.

Effect of merger on rail services on those routes

- 6.36 We noted in paragraphs 3.7 to 3.10 and Appendix C the extent of the contractual obligations concerning both the levels and quality of services operated by the Greater Anglia franchise, which effectively preclude any reduction in rail services as a result of loss of coach competition. We have also noted that a substantial majority of Great Eastern and a sizeable minority of Anglia Railways fares are regulated: Anglia Railways was the operator of the London–Norwich services but Great Eastern with a higher percentage of commuter traffic, also operated services on the London–Ipswich route. In particular saver fares used primarily for leisure travel, about which we are concerned, are regulated, but cheap day returns or low-price advance purchase tickets are not regulated.
- 6.37 We were concerned in particular about the unregulated APEX and Super Advance fares, available between London and Ipswich, and stations beyond Ipswich. The APEX fares (available only on return journeys originating in London) and Super Advance fares into London are more comparable with standard coach fares. Super Advance fares from London are priced between APEX and saver fares. The number of APEX tickets sold is less than 10 per cent the number of regulated saver fares, but the number of Super Advance tickets sold is about two-thirds the number of saver fares. Both are subject to restrictions. APEX fares must be booked at least seven days and Super Advance fares one day in advance of travel on a specified train, and for both the return journey must be booked at the same time as the outward journey, and must be within one month of the outward journey. The number of seats available is limited for APEX fares and for Super Advance tickets (some 25 and 60 seats per train respectively on those trains for which they are sold).
- 6.38 We noted from previous CC inquiries that APEX fares were in part introduced in response to coach competition following deregulation of coach services. However, the prices of these tickets are still more expensive than the coach tickets that may be considered as being more comparable (particularly the £1 ‘fun fares’). Also, even in the presence of low APEX and Super Advance fares, passengers still travel by coach, paying standard fares, despite the far longer journey times they experience. This suggests, among other things, that the restricted availability or conditions of these tickets limit the extent to which they attract passengers away from the coach. NEG also told us that its Business Plan for ‘one’ assumed the continuation of availability of both types of ticket, and there had been no change in that assumption since the preparation of the Business Plan. As discussed in Appendix I (see Figure 3), given the high elasticity of demand for leisure travel, our calculations suggest that it is unlikely to be profitable to withdraw those fares.

- 6.39 For the reasons set out in paragraphs 6.36 to 6.38, therefore, we do not believe rail fares would be higher as a result of the merger, or that there would be any effect on the level of rail services.
- 6.40 The OFT, however, showed us a potentially important piece of analysis that suggested that, for the 52 overlaps it had identified as being affected by the merger:
- (a) Rail fares, particularly peak rail fares, tended to be higher, the longer and less competitive were coach journey times relative to rail.
 - (b) Off-peak rail fares also varied with coach fares.
- 6.41 We discuss the OFT analysis in Appendix J. We found on the substantive overlap flows, that there is a correlation between off-peak (but not peak) rail fares and relative journey times. We also found there to be a correlation between coach fares and off-peak rail fares even after allowing for distance which could affect the cost and fare structure of both. Nonetheless, such correlation could well reflect factors other than competition. It is in particular unlikely in our view that competition from coach services on the overlap flows we are considering would constrain rail fares. As we noted in paragraph 6.24, the cross-price elasticity of rail demand to coach fares or other aspects of coach services is very low on these routes, given the low share of coach travel.
- 6.42 The relationship between coach and off-peak rail fares is we believe more likely to reflect coach fares having been set on the basis of rail fares, rather than vice versa. We have noted above that coach fares were, until around four years ago, set on the basis of a discount from rail fares, but NEG told us such a relationship is no longer applied due, in part, to the complexity of the rail fares structure. Fares were now set, it said, with reference to what NEG believed passengers would travel for, and had nothing to do with what rail fares were. We have noted above that the degree of substitutability between rail and coach is relatively limited on those routes. Nevertheless, given the way that both coach and rail fares are set and updated in relation to RPI or other general increases in inflation, it is likely that some elements of the previous relationship could still be reflected in the current fare structure.
- 6.43 Even to the extent that there has previously been some relationship between rail and coach fares or that the relationship continues, our analysis above suggests there is no reason to expect the merger to affect coach fares or rail fares or the level of services on the routes we are currently considering.

Prospects for entry

- 6.44 We discuss prospects of entry in Appendix K. We think new entry on either the rail or coach services is unlikely: but given we do not believe the merger is likely to affect competition between rail and coach services for the reasons set out above, this is not relevant to our findings.

Conclusion on the effect of the merger on rail:coach competition

- 6.45 We have therefore concluded:
- (a) there are some 16 overlap flows on six coach routes which give rise to possible concern;

- (b) the frequency of the coach services is limited, and coach generally has a small share of public transport passengers on many of these overlap flows, suggesting competition between coach and rail services is also likely to be limited;
- (c) there is a modest degree of substitutability for leisure passengers between coach and rail services on these overlap flows;
- (d) however, it is unlikely that it would be profitable for NEG to raise fares on these routes or reduce services to attract passengers from coach to rail given, in particular, the loss of network revenues from passengers connecting from these routes to other services; and
- (e) we also do not believe rail fares would be higher on these overlap flows as a result of the merger, or that there would be any effect on level of rail services.

We do not therefore expect the merger to result in a substantial lessening of competition between coach and rail services in the Greater Anglia area.

7. Assessment of competitive effects of the merger on competition between rail services

- 7.1 We now consider the effects of the merger on competition between rail services. Some of the concerns expressed to us by third parties related not to the effects of the merger as such, but to the effects of the SRA policy of integrating the Greater Anglia franchise. It was clear from the evidence quoted to us that this had had the effect of removing price competition on some fare categories on some services. Fare increases of up to 30 per cent were quoted to us.²⁸ We were also told that off-peak tickets on Great Eastern between Ipswich and London had previously been valid on return journeys in the evening peak period: this was no longer allowed on any Greater Anglia services, representing a significant increase in ticket prices for passengers wishing to travel off-peak into London but return at peak times.²⁹
- 7.2 Both NEG and the SRA told us that there had been some reductions as well as increases in fares as a result of the integration of the franchises. NEG also told us that it was considering options to restore some availability of off-peak return tickets in the evening peak periods. Both NEG and the SRA also said that the integration of the franchise, and the fare increases that resulted, would have occurred irrespective of who had acquired the franchise. Nonetheless, these instances do show the scope for fare competition between TOCs, and the potential effect of loss of competition between TOCs on fares, particularly in regard to unregulated fares, although the competition in those cases was on identical point-to-point flows.
- 7.3 We have considered whether similar effects could occur as a result of the merger, firstly on services between Peterborough, Cambridge and Norwich; and secondly, on the Greater Anglia and c2c rail services between London and Southend.

²⁸We noted, for example, a press article in which withdrawal of lowest price tickets on the Norwich—London via Cambridge line—affecting passengers from Wymondham, Attelborough and Thetford travelling to London via Cambridge—was attributed by a spokesperson for NEG to lack of competition. NEG told us that these fares were merely an anomaly. Anglia Railways had abolished its supersaver fares early in its franchise, but overlooked those fares because it had no economic interest in them; it had discovered them before NEG took over, and got rid of them without any involvement from NEG.

²⁹We received further criticisms of these changes in fares between London and Ipswich in response to our provisional findings.

Peterborough–Cambridge–Norwich services

- 7.4 The OFT said it was unlikely that the merger would raise any substantial competition concerns on the Central Trains and Greater Anglia rail services between Peterborough, Cambridge and Norwich.
- 7.5 All tickets for the overlap flows on those lines are inter-available for use on both TOCs' services, and we were told that Central Trains sets the inter-available fares for both operators on them. Neither of the TOCs had introduced lower fare tickets available only on its own services. There was therefore no fare competition on these services before the merger.
- 7.6 Secondly, the level of services is primarily determined by the franchise agreements including the stations the operators are required to serve. For example, the longer distance services currently operated by Central Trains on these routes were previously required to serve smaller intermediate stations, whereas the shorter distance trains operated in the Greater Anglia area were required not to do so: under the new franchise, that situation has been reversed by the SRA. Although Central Trains could increase its services, this is unlikely to be profitable.³⁰
- 7.7 Thirdly, there are alternative bus services operating on most of those generally shorter distance flows between intermediate stations. Although bus journey times are longer, bus services are in many cases more accessible to town centres and to residential areas. Some of the bus services are also more frequent than the train services (for example, Norwich–Wymondham).
- 7.8 There is also a larger proportion of leisure traffic on such rural routes, with higher fare elasticity, further constraining NEG's ability to impose fare increases as a result of the merger.
- 7.9 We therefore believe that the merger is unlikely substantially to affect competition on the services between Peterborough, Cambridge and Norwich.

London–Southend services

- 7.10 Concern was expressed to us by commuters and commuters associations about the merger, particularly the prospect of increases in regulated fares, and about recent and planned reductions in capacity on c2c. One commuters association, for example, argued that potential substitutability between c2c and Greater Anglia on some parts of the lines would, in the absence of the merger, act as a disincentive to such actions on those and other parts of the lines; hence the merger, by removing competition between the lines would adversely affect fares and services. NEG and the SRA told us that the reductions in capacity were unrelated to the merger. NEG admitted that cost reduction was an objective of the capacity reductions, but they had occurred, with agreement of the SRA, because traffic growth had been lower than expected, there was a lower level of overcrowding compared to other rail services into London, and there was a need to transfer rolling stock to Silverlink to remedy shortages of capacity resulting from the West Coast Main Line redevelopment. NEG also said that the rolling stock would revert to c2c in summer 2005 unless the SRA agreed

³⁰Subsequent to our issuing of the provisional findings, we received criticisms of changes in services between March and Peterborough, that had increased waiting times for connections at Peterborough. NEG told us that, in response to such complaints, it had inserted a stop at March in another service which connected at Peterborough with one from London. The changes to the timetable had, however, been to meet pressure to improve services between Peterborough and Ipswich, including introduction of through services between Peterborough and London via Ipswich; the change in timetable was agreed with the SRA for this purpose, given network constraints, rather than being a result of the merger.

otherwise, which would depend on the growth in traffic and any evidence of overcrowding at that time.

7.11 We noted the Londonlines three-year strategy plan 2005–2007 suggested [X]:

[X]

7.12 Among the proposals referred to are: '[X]' and 'the possibility of adding the current flexible time season ticket to fare basket, such that revenue foregone can be added to normal season ticket prices'. Cost saving options were also given, including reducing 12-coach trains to eight coaches.

7.13 In the 'one' strategic plan 2005 to 2007 there was also a reference to 'fares revisions generally applied across the board, although sensitive to competition from c2c on the Southend routes'. NEG told us this document was written by those taking the business over and with less direct knowledge of the business. In practice Great Eastern fares increases had been biased towards the other parts of the routes where business was stronger and track capacity restricted. We have, however, undertaken our own analysis of the extent of competition between the two lines, and the effect of the merger.

7.14 In assessing the effect of the merger on competition between rail services between London and Southend, we have considered:

- (a) the extent of overlap between the two lines;
- (b) market shares of the two lines;
- (c) substitutability between the two lines; and
- (d) the effect of the merger on competition between these services.

The extent of overlap between the two lines

7.15 As evident from Figure 1, although the two main Southend stations on the two lines—Southend Central and Southend Victoria—are located close to each other, the two lines serve largely different communities between London and Southend. There are areas between the two lines, however, in which the extra distance to access the alternative line is fairly limited.

7.16 We noted in paragraph 4.3 that catchment areas of different stations may overlap. The distances over which passengers are prepared to travel to a particular station will depend on their particular circumstances. NEG told us (and our survey broadly confirmed) that some 57 per cent of passengers on the two lines walk to the stations they use, varying from 27 per cent (Benfleet) to 88 per cent (at Southend Central). Except in the case of the two Southend stations which are only a few hundred metres apart, to switch to a station on the other line would require those passengers to incur the additional cost of travelling by bus or car to use the alternative route.

7.17 33 per cent of passengers drive, or are driven, to the stations, and 6 per cent travel by bus, but with the bus share at 10 per cent or above at Rayleigh, Basildon and Benfleet (where it is 25 per cent). Some localities are at a considerable distance from a station and passengers would have little option but to use a bus or car to travel there. Overlap areas could also be potentially greater for those passengers. However, NEG also showed us figures that about 94 per cent of the limited car

parking capacity on both lines is currently used, with an average of only some 100 spare spaces a day at c2c stations, and 200 at Great Eastern stations, which would inhibit switching between the two lines.

7.18 The closest stations on the two lines where the scope to switch between them is likely to be greatest are Southend Victoria and Southend Central, which are only 450 metres, some 10 minutes walk, apart. Within Southend, however, maps of catchment areas shown to us by NEG showed that overlaps extend as far as Shoeburyness to the east of Southend; and to areas to the west and north-west of Southend roughly equidistant to the two lines. One resident in the north west of Southend, for example, told us he found it easier to travel by bus to Rayleigh station on Greater Anglia than Leigh-on-Sea on c2c, and the frequency of such bus services also suggests a degree of substitutability between the two lines in that area, although Rayleigh and Leigh on Sea stations are some five miles apart. As we discuss further below, the survey we carried out of passengers on the two lines also showed that there were a number of stations in the Southend area in which a substantial proportion of passengers said they could easily switch to the other line.

7.19 The OFT was concerned that there could be other intermediate stations between London and Southend, from which passengers could potentially switch to the other line. NEG noted that, outside the Southend area, the closest intermediate stations on the two lines were between eight and 11 kilometres apart: a distance over which it was impractical to walk, or difficult to use other means of transport given the configuration of bus routes and shortage of car parking capacity. We also noted that, although suitable north-south road links are available, there were only a few populated areas between the two lines, where one line is likely to be similarly accessible to the other (see also Figure 1):

- (a) There is an area between Rayleigh and Benfleet station (some 8 km apart) similarly accessible to both, but NEG told us that only 3 per cent of Greater Anglia's catchment area customers lived in the same catchment area as c2c's Benfleet station. Peak fares are significantly higher for Rayleigh.
- (b) Billericay station is some 10 km from both Laindon and Basildon, and Wickford and Pitsea stations are some 8 km apart. There are some residential areas of Basildon where the difference in distance from the two lines is less than 3 km. To switch to the less accessible line would, however, require a longer or less frequent bus journey, or longer driving time. Peak fares are again significantly higher on Great Eastern.
- (c) NEG estimates about 7 per cent of Greater Anglia's Brentwood catchment area customers and 4 per cent of its Shenfield catchment area customers live in the same catchment area as c2c's West Horndon station. The stations are some 10 km apart. Most Brentwood passengers walk to the station, and would clearly not be able to walk to West Horndon. Peak fares are also significantly higher from Brentwood.

Within the M25 area the merger is unlikely to be of concern, given the alternative underground services and the availability of Travelcards for travel on all public transport services (at prices applying throughout London and agreed with TfL).

7.20 Overlaps between the two lines are likely therefore to be primarily within the Southend area. Although wider than the area served by Southend Central and Victoria, even in the Southend area only a minority of passengers may have a realistic choice between the two lines. Outside the Southend area, an even smaller minority of passengers is likely to have a realistic choice between lines (except in

exceptional circumstances, for example if one of the two lines is not operating, when tickets are generally allowed to be used on the other line). Outside Southend, passengers resident close to stations on either line, or north of the Greater Anglia line, or south of c2c would in particular face a significantly longer journey time to switch. We have therefore focused on the overlaps within the Southend area.

Market shares

- 7.21 The stations on the two lines closest to each other are Southend Central on c2c and Southend Victoria on Greater Anglia. NEG figures showed that, of the total revenues on flows between these two stations and London in 2003, Great Eastern, now part of the Greater Anglia franchise, accounted for about two-thirds and the c2c franchise for about one-third. Over a wider Southend area, as shown in Appendix F, the position is reversed.
- 7.22 NEG subsidiaries are now the only operators of rail services between London and Southend. Rail is the predominant mode of transport on this route. There is, however, an independent operator of coach services between London and Southend, providing services in peak hours for commuters and off-peak for leisure passengers, but the frequency of those services is very low—some eight services a day each way compared with about 150 rail services. We were told that there had been a significant decline in the level of express bus/coach services in the last few years (a half-hourly express bus service, more frequent at peak times, having been advertised by its operators as recently as 2001). The SRA estimated that, taking into account the capacity offered by the two modes of transport, the share of the coach market might be as little as 1 per cent. Journey time is longer, between 1 hour 50 minutes and 2 hours 27 minutes, compared with, on average, 55–56 minutes by rail; coach fares are significantly below peak rail fares, but comparable with off-peak rail fares.
- 7.23 Table 6 compares the levels of service and fares on journeys between the London and Southend termini on the two lines (tickets are generally not interchangeable, between the two lines).

TABLE 6 Relative characteristics of Southend services

	c2c Southend Central— Fenchurch Street	GA Southend Victoria— Liverpool Street	c2c as % GA
Frequency: peak (0730 to 0830)	8	7	
Off peak (Mon–Fri 1300 to 1400)	4	3	
Journey time: peak (mins)	51–59	59–64	
Off peak	52–58	55	
	£	£	
Flexitime annual season	1,940	N/A	N/A
Annual season	2,280	2,500	91
Annual travelcard†	2,880	2,980	97
Standard weekly	57	62.50	91
Weekly flexitime	48.50	N/A	N/A
Weekly travelcard†	72	74.50	97
Peakday travelcard†	15.80	23.30	67
Off-peak day travelcard†	12.30	12.80	96
Cheap day rate	9.70	10.20	95
Standard day return	11.80	19.50	61
Single	7.30	10.10	72
	Fenchurch Street— Southend Central £	Liverpool Street— Southend Victoria £	
Cheap day return*	9.70	10.20	95
Standard day return	11.10	10.80	103
Standard single	7.30	10.10	72

Source:

*Only valid on Monday to Friday from Liverpool Street after 0930; from Fenchurch Street any time.

†Including all zones London Travelcard.

Note: N/A = not applicable.

7.24 As apparent from Table 6, almost all fares from Southend–London on c2c are cheaper, some significantly, than on Greater Anglia, but the percentage difference is lowest in the case of the unregulated cheap day return fares and tickets including London Travelcards. Such differences in fares also do not necessarily correspond to difference in generalized cost to users of the services, which we discuss in paragraph 7.28. c2c has also introduced a flexitime annual season ticket, currently unregulated, at a discount off the price of a full annual season ticket, not valid on trains arriving in London between 0715 and 0915.

7.25 Lower regulated fares on c2c are, however, primarily a result of restriction on fare increases for several years on account of the earlier poor levels of service on this line. NEG also told us that different fare policies partly reflected different operational characteristics of the services; for example, it is possible for c2c trains arriving in London shortly before 0715 to do a further return journey within the peak period, hence it was economic to offer season tickets at lower fares for travel before 0715 to attract passengers to travel at that time.

Extent of substitutability between the two lines

7.26 NEG argued that even when the catchment areas of the two routes overlapped, there was no competition between the two lines but passengers' choice between them reflected other factors. These included accessibility to the passengers' origin and destinations, including the easier connections with underground services at Liverpool Street served by Greater Anglia than at Fenchurch Street (close to Tower Hill) served by c2c; journey time; frequency of services etc. NEG believed such factors would

even determine whether within Southend passengers would choose to use services from Southend Victoria or Southend Central, the stations on the two lines closest to each other.

7.27 We therefore conducted a survey of rail passengers within the Southend area, where potential substitutability is likely to be greatest. The survey confirmed journey characteristics to be major factors in the choice of which route to use, the main advantages of using their existing lines with which respondents agreed being proximity to home and to final destination and speed of journey; but with relative fares among a range of other relevant factors.

7.28 The survey also asked what would be the additional time and cost in using the alternative routes. As shown in Table 7, the current choice of routes of those knowing how journeys compared reflects the relative generalized cost of using the two routes. The difference in fares is significantly less than the perceived difference in costs of accessing the other route. Moreover, to switch to the other route would involve a significant increase in perceived journey costs; or, conversely, it would take a significant increase in fares (of 49 per cent on c2c or 29 per cent on Greater Anglia) for passengers to switch between the two lines.

TABLE 7 Comparison of generalized cost of using c2c and Greater Anglia rail services between London and Southend area*

	c2c		Greater Anglia	
	Current route	Alternative route	Current route	Alternative route
Total journey time†	80 mins	93 mins	83 mins	94 mins
Value of journey time	£6.73	£7.78	£6.96	£7.91
Costs to station	£0.34	£1.20	£0.58	£1.87
Cost of car parking	£0.17	£0.35	£0.18	£0.59
Cost of ticket per journey	£5.35	£4.96	£7.06	£5.38
Costs from station	<u>£0.49</u>	<u>£1.41</u>	<u>£0.59</u>	<u>£1.65</u>
Total	£13.08	£15.71	£15.36	£17.40

Source: CC study.

*Based on responses from passengers answering each individual question.

†Including journey times to/from station.

7.29 We asked passengers how easy it would be to switch between lines. Only 45 per cent of the survey respondents knew how journey times compared. Of those about one-quarter (but this was only about 10 per cent of all passengers) said that they could easily switch their train route. For individual stations (for which, however, the sample size was only small), about 50 per cent of Southend Central passengers (who knew how the journeys compared) could easily switch; between 30 and 40 per cent of Southend Victoria, Westcliff and Prittlewell passengers; between 20 and 30 per cent of Southend East and Rayleigh passengers; and between 15 and 20 per cent of Leigh-on-Sea and Rochford passengers. Less than 10 per cent of passengers at Chalkwell, Hockley and Benfleet said they could easily switch. A similar proportion of commuter and leisure passengers said that they could easily switch.

7.30 The percentage of respondents who would switch between lines, and the average price increases required for them to do so, is summarized in Table 8.

TABLE 8 Potential switching between c2c and Greater Anglia

Of the whole sample of respondents travelling between London and the Southend area:

	<i>per cent</i>	
	<i>c2c passenger</i>	<i>GA passenger</i>
Know how services compare	39	47
And find it not difficult to switch to the other route	19	18
And would switch in response to a price increase	6	6
Median price increase required	+15	+13
% who would switch in response to		
—5 per cent price increase	0.8	0.8
—10 per cent price increase	2.2	2.7

Source: CC analysis of survey results.

Of those passengers knowing how services compare, a 15 per cent increase in c2c fares would result in 6 per cent of passengers switching to the other line as would a 13 per cent increase in Greater Anglia fares.

- 7.31 Based on existing literature, Professor Wardman recommended own-price elasticities of -0.8 for Southend commuting, -0.95 for Southend business and -1.63 for Southend leisure. Taking into account market shares and the diversion ratios based on our survey results, cross-elasticities were generally below 0.5. The implication of that analysis is that for commuting and business traffic, fare increases (if there were scope under the franchise to increase fares) would be profitable, irrespective of the merger. For leisure passengers, fare increases would be unprofitable without the merger. About one-third of the elasticity he estimated for leisure passengers on reduced fares would result from passengers switching to the other line: suggesting there would be little or no increase in profitability were fares of the two lines to increase by the same amount.³¹
- 7.32 NEG also provided us with graphs showing monthly changes in the number of standard single, season and off-peak tickets between Southend and London on the two lines, compared to changes in fares on these routes, as further evidence of little actual switching between them. We noted some instances where changes in fares could be regarded as affecting the distribution of traffic between the two routes: for example, in 1996, Great Eastern cheap day return fares increased, c2c's decreased; the number of Great Eastern's cheap day returns fell, c2c's marginally rose. Similarly in 1998, c2c season ticket prices increased significantly more than Great Eastern; the number of c2c season tickets fell over next two years, those of Great Eastern increased. But even in those instances, NEG argued that the change in the number of passengers reflected a range of other factors, in particular the effect on quality of service of signalling or track developments, or problems in introduction of new rolling stock. In other years, we saw no obvious relationship. NEG also noted that there had been a 25 per cent reduction in commuting numbers into Liverpool Street between 1990 and 1992, followed by a recovery to pre-1990 levels; c2c commuting numbers had declined by 33 per cent from 1990 to 1995, recovering by only 14 per cent since. This was despite the relative decline in fares of c2c and the recent improvements in c2c services.

³¹On the basis of survey results alone ITS estimated an own-price elasticity of overall demand of below 1 for both routes and cross-price elasticity of demand also below 1, but, as noted in the footnote to paragraph 6.24, we regarded the estimates based on the existing literature as the more appropriate basis for analysis.

- 7.33 Given the range of factors affecting the number of passengers on the two lines, it would be difficult in our view to interpret this information as showing a high degree of substitutability between the two lines. The current fares differentials shown in Table 6 have arisen largely as a result of fare increases being capped by regulation but actual switching between lines has not been sufficient to restrict fares on Great Eastern to below the regulatory levels allowed. This is not surprising given, as shown in Table 7, the lower generalized cost of the route currently chosen by passengers, and the significant increase in such cost if they switched to the other line.
- 7.34 A further indication of the lack of substitutability between lines was apparent from a survey by the London Transport Users Committee, 'Which street for Southend', asking passengers who generally use Fenchurch Street about their views on whether late evening services should continue to operate from Liverpool Street. About three-quarters of passengers preferred Fenchurch Street to be used at all times; the main reason given was consistency in the pattern of service to reduce confusion.
- 7.35 There is therefore in our view only a limited degree of substitution between the two lines on journeys to and from the Southend area, which would be unlikely to be sufficient to prevent c2c from wishing to raise fares or reduce services were the services to have remained under separate ownership. Irrespective of the merger, c2c was under pressure due to its financial position to raise fares or reduce services, if permitted to do so, and had put proposals for doing so with the SRA before NEG was declared preferred bidder for the Greater Anglia franchise.
- 7.36 The OFT showed us an analysis suggesting fares between London and Southend (on a pence per mile basis) were relatively low compared to similar routes where there was no competition. NEG provided a comparison of regulated standard and unregulated cheap day return fares per mile on 62 routes where there is no choice of operator. We accept that unregulated cheap day return fares between London and Southend do not appear lower than fares for similar journey lengths not subject to rail on rail overlap. Although regulated fares on c2c and on Greater Anglia (from London–Southend rather than Southend–London) were toward the lower end of the range, this is in our view more likely to be due to reasons other than competition: for example, the historical pattern of fares; the relative income levels of the areas served; regulation; and the relationship of unregulated with regulated fares on the respective lines. In our view, there is insufficient basis for us to conclude that competition between services to Southend has resulted in significantly lower fares.

Effect of the merger

- 7.37 To the extent that there is some, even limited substitutability between the two lines, the merger could be regarded as increasing the incentive on NEG to raise fares on one or other of the routes, in particular c2c whose fares are currently relatively low: any loss of passengers to the other line would represent an increase, rather than a reduction, in its revenues.

Implications of regulation

- 7.38 As discussed in Appendix L, however, the scope to increase fares or reduce services is limited by regulation. For example:
- (a) There is negligible scope to reduce service levels. The Greater Anglia service level commitment does not permit any change in service levels without SRA approval. The c2c passenger service requirement (PSR) also sets minimum

levels for services; as c2c is operating only 1 per cent above its PSR, NEG has very little scope to reduce services.

- (b) On possible cuts in train and station operating and capital costs, NEG has to maintain the train fleet specified in the franchise agreements, subject to the SRA's consent to any changes, and use all the train fleet (except for vehicles undergoing maintenance) in peak periods, and sufficient vehicles off peak to ensure no overcrowding beyond defined standards. The number of drivers, conductors and customer service staff in Greater Anglia is set out in that franchise agreement; while reducing maintenance costs would cause problems in meeting the required quality of service standards. NEG is also committed to making various investments and service improvements in its bids for the Greater Anglia franchise.
- (c) On cuts in quality of service, NEG has to comply with the range of service quality standards.
- (d) We have noted that a substantial majority (some [x%] per cent) of revenues are derived from regulated fares on both lines. NEG also told us that both Great Eastern and c2c had priced their respective fares basket at the full regulated permitted maximum. A larger than average increase in regulated fares on journeys to or from the Southend area would have to be offset by reductions elsewhere in the fares basket. NEG would have scope to target the permitted maximum RPI+6 per cent increases, within the RPI+1 limit on each franchisee's overall basket, on either or both London–Southend lines, and we did consider whether the merger could increase the incentive to focus such increases on the Liverpool Street–Southend route. However, we noted above its intention to focus increases elsewhere in Great Eastern, given capacity constraints on those other lines. Any significant differentials in fare increases on the c2c lines would distort the fare structure between nearby services; they would also be very obvious to passengers and likely to generate complaints.

7.39 There was, however, concern among passenger organizations that the SRA (or its successor bodies) might agree to any proposed increases in the regulated fares basket, given its need to finance other parts of the rail network and the financial constraints under which it operates. We saw no evidence that SRA would be sympathetic to any requests for fare increases out of line with those permitted elsewhere. But, even were the SRA (or its successor bodies) to be sympathetic to any request for increases in regulated fares, this could occur irrespective of the merger, and c2c would have an incentive to increase fares in any event.

Effect on unregulated fares

7.40 There may be more reason for concern about unregulated fares. However, the extent of substitutability between the two lines for off-peak travel does not in our view suggest sufficiently strong competition between them materially to affect the current level of fares. The high elasticity of demand for leisure travel, irrespective of the merger, is itself likely to restrain fare levels: an increase of fares would reduce rather than increase revenues, and, given the high level of fixed costs, profits. As stated in paragraph 7.31, Professor Wardman suggested an own-price elasticity for Southend leisure rail travel of -1.63 . At this level of price sensitivity, the extra revenue from higher fares would be more than offset by the loss of revenue from switching passengers, and would thus, given that costs are almost fixed, reduce profits.

Competition from other public transport operators and new entry

7.41 We discuss prospects of entry in Appendix K. There is little prospect of entry from new rail operators on these services and although there is an operator of coach services between London and Southend the extent of competition from coach to rail in such circumstances is likely to be very limited. However, our findings are not dependent on this point, given that we do not believe the merger will result in a substantial lessening of competition on rail services between London and the Southend area.

Conclusion on effects of merger on London–Southend

7.42 In our view, therefore:

- (a) the actual or potential overlap in catchment areas serving the two lines is largely limited to the Southend area, and only a minority of passengers within that area are likely to have a realistic choice between the two lines;
- (b) there is only limited substitutability between services on the two lines; the actual degree of switching between the two lines also appears to have little effect on the fares charged;
- (c) even to the extent that there is limited substitutability between the two lines, the scope to increase fares or reduce services on either line is limited by regulation; and
- (d) as regards unregulated fares, the high elasticity of demand for leisure travel irrespective of the merger, is itself likely to constrain fare levels.

We do not therefore expect the merger to result in a substantial loss of competition on rail services between London and the Southend area.

8. Conclusions on the effect of the merger on competition

8.1 The OFT reference of this merger to ourselves raised potentially important issues of the effect on competition between rail and coach services between London and the Greater Anglia area, and on competition on rail services particularly between London and Southend. In the greater time available to us, however, which in particular allowed us to carry out extensive surveys of passengers on the relevant services affected, we have found that the degree of substitutability between the services affected is only limited. We have also been able to analyse the potential profit incentives of NEG. We conclude that the merger has not resulted, and may not be expected to result in any substantial lessening of competition on public transport services in the Greater Anglia area, either between coach and rail services serving the Greater Anglia area; or between different rail services between Peterborough, Cambridge and Norwich, or between London and Southend.