

Executive summary

1. On 13 January 2004 the Office of Fair Trading (OFT) referred the proposed acquisition by FirstGroup plc (FirstGroup) of the Scottish Passenger Rail Franchise (the Scottish rail franchise) currently operated by ScotRail Railways Limited (ScotRail) to the Competition Commission (CC) for investigation and report. The reference was made under section 33 (1) of the Enterprise Act 2002 (the Act). We are required to publish our final report by 28 June 2004.
2. FirstGroup is the leading supplier of bus travel in the UK, accounting in 2003 for about 22 per cent of turnover of local bus services (almost double the figure of ten years previously). It has four bus subsidiaries in Scotland, based in Aberdeen, Edinburgh and two in Glasgow, and estimates that it operates about 35 per cent of the total route mileage of all bus services in Scotland, making it the largest operator of bus services there; over half of those operations are in the Glasgow area. As at April 2004 FirstGroup was also the operator of five passenger train operating companies.
3. The Scottish rail franchise accounts for 95 per cent of railway services in Scotland (including night sleeper services to London). The current franchise, granted to National Express, was due to end on 31 March 2004. It has, however, now been extended up to 17 October 2004. The new franchise will be for at least seven years, and can be extended to ten. FirstGroup is one of three remaining bidders for the Scottish rail franchise, which will be awarded by the Strategic Rail Authority; the other two are National Express and Arriva.

4. The award of a rail franchise is regarded, for the purposes of Part 3 of the Act, as an acquisition of control leading to two or more enterprises ceasing to be distinct (within the meaning of the Act). The current turnover derived from the Scottish rail franchise significantly exceeds £70 million. We have therefore concluded that arrangements are in progress or contemplation which, if carried into effect, will result in the creation of a relevant merger situation.

5. The effect of the merger would be to combine the operations of overwhelmingly the largest operator of rail services in Scotland with those of the leading operator of bus services in Scotland and in Glasgow in particular. A main concern raised by the OFT in making the reference to us was the possible loss of competition on routes where bus and rail services overlapped (ie where either bus or rail services could be used to travel between two points, and which we term 'overlap flows' below) and whether bus services could be reduced or fares increased on these routes to shift passengers from bus to rail.

6. In assessing the relevant markets affected by the merger, we have considered two sets of customers—fare paying passengers and public authorities, who are also involved in funding both bus and rail services. We found that rail services and bus services are, at least for certain people on certain routes (where the alternative of rail or bus services are available) and at certain times of the day, potentially substitutable. In our view, it is appropriate to regard point-to-point public transport journeys as relevant local markets; but there are also relevant public transport network markets such as the Strathclyde Passenger Transport Executive (SPTe) area, Edinburgh and the Lothians, and, in some contexts, Scotland as a whole.

7. We found 30 bus routes where revenue from overlap flows account for more than 10 per cent of total revenue on the route, a large enough threshold, in our view, to make it likely that FirstGroup would find it to be in its interest to change the operation of the route to take advantage of the overlaps following the merger. We also identified 16 other routes where, although current overlap flows are more limited as a percentage of route revenue, it is likely to be profitable for FirstGroup to reconfigure services as feeder services to railway stations increasing the potential size of the catchment areas, combined with withdrawal at least in part of direct services. Finally, we considered a further eight routes where specific concerns were raised by local authorities. Of these 54 routes where the possibility of adverse effects resulting from loss of competition arises, we provisionally identified 24 routes in the Glasgow and Edinburgh areas where there are no competitors on overlap flows operating 'in hours'—roughly between 7 am and 7 pm on Mondays to Fridays and Saturdays—at sufficient frequency to compete effectively with FirstGroup. For those routes we believe that competition would be significantly reduced as a result of the merger. We also provisionally identified 31 routes (including many of the 24 previously identified) on which competition on overlap flows would as a result of the merger be significantly reduced 'out of hours' (typically between 7 pm and 7 am on Mondays to Fridays and Saturdays and on Sundays), when few competitors to FirstGroup operate. Furthermore, we would expect that other routes might come into being during the term of the Scottish rail franchise with similar characteristics and give rise to similar problems.
8. In our view, neither the existing undertakings relating to FirstGroup's bus operations, nor any constraints resulting from FirstGroup's fare structure would be sufficient to prevent adverse effects which may be expected to

result from the merger. Entry or expansion by an existing operator can also not be expected to provide a sufficiently effective source of competition to offset the loss of competition on those routes resulting from the merger, particularly out of hours where few competitors currently operate.

9. The merger may therefore be expected to result in a substantial lessening of competition on overlap flows on such routes. The survey we commissioned suggested that enough passengers would switch from bus to train to make a strategy of diverting passengers from bus to train potentially profitable. We consider it would be profitable for FirstGroup to switch bus passengers from bus to rail by increasing fares, and/or, to a lesser extent, by reducing frequency or rerouting services, and/or by reconfiguring routes. After the merger it would be in a position to do so, and would, in our view, be expected to do so.
10. We also concluded that the merger may be expected to result in a substantial lessening of competition in wider public transport network markets in and around the SPTE area, Edinburgh and the Lothians and elsewhere in Scotland. After the merger, FirstGroup would account for almost 70 per cent of all revenues from the operation of public transport in Scotland. This would enable FirstGroup to introduce its own multi-modal ticket scheme, confined to its own services, to its own commercial benefit and to the detriment of any schemes open to other bus operators. This could be expected to distort competition between FirstGroup and other operators, including in areas where it does not currently operate, but where it could leverage its control of the rail franchise to extend its bus operation. It would also put FirstGroup in a strong position to influence the setting of fares of multi-operator, multi-modal travelcards, in particular the SPTE ZoneCard, to its own commercial benefit

and to the disadvantage of other operators, and it would be expected to do so. Finally, it would give FirstGroup an incentive and opportunity to favour its own bus operation in providing information at railway stations, in providing information about its rail services to bus operators, and in joint marketing of services to its own commercial benefit and to the disadvantage of other operators, and it would also be expected to do so.

11. The substantial lessening of competition that would be expected to result from the merger would be expected to have the further adverse effects of higher bus fares, poorer services on overlapping bus routes, and reduction in choice of services available to passengers on overlap routes. Similar adverse effects on other services would result from the effects on the broader network markets noted above.