

POLISH TRANSPORT HOLDINGS

COMPETITION COMMISSION STAGECOACH AND SCOTTISH CITYLINK

**Report on the completed joint venture between Stagecoach
Bus Holdings Limited and Braddell plc in relation to
megabus.com, Motorvator and Scottish Citylink
Dated 23 October 2006**

COMMENTS

The following comments are in response to the above report.

RELEVANT EXPERIENCE

My name is Chris Watts. I am a Public Transport professional with the following 33 years experience, with particular reference to public transport competition and long distance coach services:

1973 to 1979 Leicester City Transport. Various Traffic Office positions. Gained thorough grounding in bus and crew scheduling, and special projects.

1979 to 1981 Midland Red Omnibus Co Ltd. Various Divisional Traffic Office positions.

1981 to 1990 Midland Red South Ltd. Positions included District Manager positions covering depots in Warwickshire, including National Express operation.

1990 to 1993 Midland Red North Ltd. Operations Manager for whole of this Company controlling 400 buses mainly in Staffordshire, Shropshire, Cheshire and the West Midlands.

1994 to 1998 National Express Group PLC. Group Technical Manager and Manager Polski Express, Poland.

1998 to date Polish Transport Holdings Sp. z o.o. Managing Director of own consultancy company. Significant past and present clients include Arriva, First Group, Stagecoach, and British Embassy in Warsaw.

Public Transport competition experiences

1973 to 1979 Duopoly in Leicester between Council owned Leicester City Transport and National Bus Company owned Midland Red Omnibus Co Ltd. Under previous bus regulation rules.

1980 to 1985 Relaxation of bus regulations, coach services deregulated. As a National Express operator, was involved in changing networks and providing coaches and drivers for National Express network, both regular scheduled and duplication. Experienced culture change of long distance coach services, with concentration on core inter city networks and "turn up and go" culture. Competition challenges reduced by network changes. Current National Express network has its origins from this period.

1986 to 1993 Local bus deregulation and privatisation. Experienced competition in all areas involved in. Most successful competitive techniques were firstly frequency, closely followed by reliability, and appropriate fares offers. Competition on fares alone not effective.

1994 to 1998 Introduced and managed a new Inter City coach operation, National Express style, in Poland. In 1998 was sold of to Polish owners, and concept is still in operation 12 years later.

1998 to date Periodically worked on UK projects on behalf of Stagecoach Bus division. Particular areas of work where significant competition or long distance networks are involved are, for example:

- Oxford City network: competition with Go Ahead
- Oxford Tube: Oxford London inter city coach service. In competition with Go Ahead.
- X5: Improved Inter City coach service linking Cambridge with Oxford now every 30 minutes.
- Manchester Preston Manchester: Regular inter city coach service
- Megabus network: Efficient scheduling advice provided.
- National Express Network: Provided scheduling advice on contracted operations. *I have recently completed a review of Yorkshire and London National Express operations and identified new practices which will accommodate an accelerated fleet replacement including new vehicles with wheelchair access, at minimal additional cost and at the same service levels.*
- Saltire Cross: Operations reviewed and advice provided regarding scheduling efficiency, reliability, and quality issues.

SALTIRE CROSS NETWORK

I believe my relevant experience provides the authority to comment on the Competition Commission (CC) report as referred to above.

It is my professional opinion that the current Saltire Cross services and the development potential forms the basis to be potentially the most efficient sustainable high frequency network for the travelling public and is in the best interests of the passenger.

My opinion is backed by two days intensive observations and travelling on the Saltire Cross network on Thursday 21st and Friday 22nd September 2006.

Its strengths:

- 1) It provides multiple regular direct links, or by connection, between the major cities of Glasgow and Edinburgh with Perth, Dundee, Aberdeen and Inverness, and intermediate smaller towns and villages by regular connection.
- 2) It integrates the cross border routes of London via Manchester and Glasgow, and London via Newcastle and Edinburgh.
- 3) The combination of the traditional Scottish Citylink fares structure with the Megabus fares concept of yield management and Internet/ telephone booking provides maximum fare offer combinations on the one cohesive network.

- 4) It provides the only networked alternative to the railway network, and as such puts limits on the railways ability to abuse the market, for example charging excess fares.
- 5) It provides the networked operator, Scottish Citylink, with a robust network and fares offer to challenge and maintain its presence in the face of any incoming significant competitor.

Its competitors:

- 1) **The railway.** My National Express experience, in the UK and in Poland, confirms that the Inter City coach operator must position its fares and level of service offered taking into account the offer of the railway company. What was intriguing for me was the discovery that the market responds with similarity to the key areas of fares and timetabling regardless of location. This is my experience of the UK and Poland. The Saltire Cross network and the railway network are in the same competitive arena for the Inter City transport user, and cannot be disregarded or reduced in significance. The Saltire Cross operator must take into account railway fares and service offered if it is to maintain or grow a viable market.
- 2) **Other operators.** The UK Public transport market outside London is very easy to enter for an operator. Where there is a regulatory requirement, it is simply a 56 day registration requirement with the relevant regional traffic commissioner, plus a 14 day pre notification to the appropriate transport authority.

Undesirable competition. In the initial deregulation days there was a flurry of competitive activity, especially using older vehicles, cheap fares, and lower levels of quality and standards. Whilst the public could enjoy more services, and cheaper prices, this situation is not sustainable in the longer term. In particular, it is financially structurally unsound as fleet replacement is not accounted for. Competition in this form will last as long as the older vehicles will last, and relies on a pool of older cheap vehicles for sustainability, to the detriment of quality and environmental standards, which is a modern day issue not to be ignored. This is undesirable competition and although the Industry has generally learned the lessons of its unsustainable nature, it can still be observed from time to time, the best current example being the 192 route in Manchester.

Desirable competition and dominant position. This is where passengers are provided with a choice, improved services and innovation. However, there is a very important aspect regarding the public transport market that must, in my opinion, be taken into account. Unlike many other industries, with the bus and coach market outside London there is few and low barriers to market entry. The serious, established operators know this. A wealth of experience has been built up in the last 20 years since deregulation in 1986 commenced, through lessons learned, sometimes the hard way. There have been winners, and losers.

Fact is that most bus routes outside London area are operated by a bus operator with a dominant position based on the OFT 40% rule. To quote OFT "Merely holding a dominant position is not, in itself, an

abuse". But why are there so many dominant positions both not abused and not competed with, given the relatively low entry barriers? The answer is in the wealth of 20 years market experience as referred to above. A significant feature of any modern day bus operation is to present an efficient, reliable, reasonably priced product, carefully marketed and adaptable to market changes and innovations and with sustainability. Get this right and two important events occur:

- a) Passenger numbers grow. *As has happened on Saltire Cross, as quoted in the report.*
- b) Competition is deterred, because of a higher satisfaction with the marketed product on offer. *As has happened with Saltire Cross, with its carefully scheduled network features of regular headways and connections, and the introduction of the megabus principles within the Scottish Citylink package which, offered as a whole marketed package is to the passengers benefit.*

This is not to say sustainable competition does not exist, for example in Oxford there is an almost duopoly on City services and the Oxford London corridor. This competition was born out of innovation, originally through high frequency minibus operation in a City where the concept, which had favour in the industry at the time, had not been exploited by the incumbent operator, thus leaving a market gap. The two groups owning the current subsidiaries in Oxford, Stagecoach and Go Ahead, cannot be complacent though, as other potential rivals could step into any gaps in the market.

As an interesting aside, National Express sells the Go Ahead Oxford subsidiary tickets between Oxford and London in competition to Stagecoach.

It is feasible that in some bus markets there is enough market growth for more than one sustainable network operator.

- 3) **Threat of competition.** In particular National Express Group. The CC report refers to National Express on several occasions. Consideration about National Express as a competitor to Scottish Citylink is particularly relevant for the following reasons:

- a. National Express has significant experience in long distance intercity coach operation
- b. Was previous owner of Scottish Citylink
- c. Is still an operator in the area, and has ownership of the Dundee City bus company.
- d. Since March 2005 has been released from undertakings not to expand its Scottish scheduled coach services.
- e. NEG new Chief Executive is quoted in Transit magazine as "I love competition because I just love winning, and I think competition is great because it pushes you to be even better all the time".

A significant motivation for an existing operator to satisfy its market is the threat of competition. The more the market is satisfied, the less the threat. National Express must be considered as a significant competitive threat to the Scottish Citylink operations. National Express is innovative, includes a megabus style ticketing offer, referred to as funfares. This in itself was probably borne out of itself facing innovative

competition from Megabus in England. NEG also has a CEO with competition firmly in mind. The most effective counterweight to this threat of competition is for Scottish Citylink to similarly innovate, and it has done so by its network offer, and as referred to earlier is increasing passengers, and by providing the latest market expectation of fares offers, by incorporating the Megabus concept.

Notwithstanding the disbenefits to the growing passenger base, any divestment of any element of the current Scottish Citylink offer will put the remaining offer in an unfair position against any incoming competition from National Express or similar.

- 4) **The car.** Passenger will choose public transport if it is affordable, and easily accessible and understandable.
- 5) **Competition Commission** By virtue of the divestment remedy, the Competition Commission is **THE** competition to the Saltire Cross network, and should be challenged.

COMPETITION COMMISSION DECISION

I have read the 94 page Competition Commission (CC) report, and consider that it has made the wrong decision in regard to the remedy, if indeed a remedy is required.

It appears to me that the CC has filtered its own report to reach its conclusion of a divestment remedy, by weakening or discounting elements of the report, and its own previous track record of decisions and publications, in particular the document entitled "The OFT and the Bus Industry", which I thought was a very useful guideline to operators, and put into context elements of the Competitive Act 1998 as is relevant to the Bus Industry.

In particular:

Fares

The report seems to focus on fares and the changes to fares since Scottish Citylink and Megabus joined forces.

"It is in passengers' interests for fares to be at a reasonable level – a level that reflects the costs of running the service. Cutting fares to force a competitor to cease operating is not in passengers' interests. Once there is only one operator on the route fares are likely to rise and the quality and frequency of services is likely to be reduced...."

Megabus is a relatively new innovation, and in its original introduction focused on cheap fares and cheaper operation. It appears that, with experience, fares require a wider approach and, as referred to above, a more sustainable quality offer with maximum efficiencies is what is required for the bus market. The initial fares offers have to be seen as *promotional*, and *not sustainable* in the longer term, and are therefore not relevant in considering future sustainable fare levels.

However, the OFT make a relevant point about the likely, although by no means certain, consequences of having one operator on the route. Thus the

correct remedy, if one were needed, is conditions regarding fares, and quality and frequency of services.

Divestment will not achieve the goal of lower fares without lowering quality and innovation.

The main parties have offered fares and service level remedies, acceptable in previous cases, so what is the problem...?.

Competition

The report does not appear to give due regard to its contents and attachments. The Saltire Cross operator has to have due regard to the railway, competitors and especially the threat of competition, and especially National Express Group, the car, and the Competition Commission itself, including the relevant laws, previous case history and the OFT publications.

Divestment will weaken the ability of Scottish Citylink to compete; any divestment of any element of the current Scottish Citylink offer will put the remaining offer in an unfair weaker position against any incoming competition from a stronger National Express or similar.

The market

The competition commission should put more weight behind the market advantages, and thus the passenger, of the Scottish Citylink/ Megabus combination. The report and attachment details a number of advantages, in particular, I note the following benefits:

- Frequency and easy to remember times
- The network, which includes a number of useful regular combinations requiring only one service change.
- Choice and availability of fares. The combination of the innovative Stagecoach Group through Megabus, with the more traditional Scottish Citylink, has given the passenger a range of options never before available. Megabus has brought the concept of advance booking through Internet, and telephone, now copied by others. Citylink offers the more traditional sales outlets.
- Effective load monitoring, and duplication planned and provided to maximise market satisfaction, within controlled cost criteria. *It may be interesting to note that in the 1990's National Express moved away from satisfying the market by restricting duplication and "walk on" fares. This monopolistic approach was substantially broken by Megabus, which not only brought innovation to the market, it also started to return to the Inter city coach market the capacity to satisfy again the previously suppressed market. This may explain at least in part the growth in the Saltire Cross market, which divestment will put at risk by dismantling the current innovations.*

Divestment dismantles the current advantages and is likely to reverse the passenger growth resultant from the current offer

Divestment will lead to reduced services and discourage innovation, as it will reverse the network advantages and wider range of fares option currently on offer.

Sustainability

The CC do not seem to give due regard to the subject of sustainable operation. Divestment will reduce the ability to sustain in the longer term the operations. There are benefits to mergers, which can be the best solution in order to provide benefits to the market that would otherwise be lost.

In particular:

Cost efficiencies.

- I have examined the Saltire Cross network, and conclude that the current network, or expanded network, will deliver maximum efficiencies, taking into account that it is necessary to maximise vehicle efficiency in order to allow a sustained fleet replacement programme to be introduced. Without particular skilful care, the coach and driver costs of Inter City operations will easily escalate and inhibit the ability to upgrade (average age around 4 years), or even naturally replace (average age around 8 years) the coach fleet.
- It is apparent in the report that the CC has significantly failed to consider, or it has ignored, the additional cost of operating a divested Saltire Cross network, unless of course this cost can be passed on to the consumer, but surely this is not the objective, not in the public interest, and in any event market conditions still apply as a constraint to prices.
- Driver costs in particular have to be efficient, if costs are not to unduly increase impacting on the ability to replace the assets. All Inter city driver costs are subject to the ever increasing costs of complying with EU hour's legislation, as currently described in the publication PSV 375. The most cost effective method of scheduling is to schedule the drivers separately from the coach diagrams. Thus, any divestment will reduce this efficiency and will put the cost of operation up, resulting in higher fares, and or reducing fleet replacement, and may also put at risk marginal journeys thus reducing the timetable on offer.
- **Fleet replacement**
The joint venture has given proposals that will maintain vehicle quality over and above normal fleet replacement norms. This is particularly significant and important factor for two reasons:
 - 1) It will accelerate the introduction of wheelchair access coaches, thus opening up the market faster to a mobility impaired group otherwise restricted.
 - 2) It will accelerate the introduction of coaches with Euro 4 engines, particularly important on environmental grounds.

Divestment will increase cost of operation through a combination of less efficient fleet utilisation and more expensive drivers' duties. This will slow down the fleet replacement programme which will have an adverse impact on the mobility impaired and on environmental grounds.

Future improvements

The CC does not appear to have any regard to future innovations and improvements. In fact, the uncertainty the current investigation creates has inhibited changes and created a “lost year” in service improvements to the travelling public in Scotland.

My own observations, which I have passed on in detail to Stagecoach, reveal a number of potential improvements which, without the CC, would now be in progress, namely:

- Reliability issues. There are a number of cosmetic changes that could be made to improve reliability. Given the CC appears intent on dismantling the current operations; there is no clear path to follow to make any changes. Lifting of the divestment remedy will immediately permit the Joint Venture to make changes to improve reliability.
- Further timetable improvements lost by the divestment remedy.

The divestment remedy has halted reliability improvements and plans to improve the timetable

Conclusion

In my professional opinion the Competition Commission should take this consultation period on the detail of the divestment as an opportunity to revisit its decision, and in doing so seek behavioural obligations as an alternative, if any remedy is applicable, taking into account, in summary:

It is my professional opinion that the current Saltire Cross services and the development potential forms the basis to be potentially the most efficient sustainable high frequency network for the travelling public and is in the best interests of the passenger.

Divestment will not achieve the goal of lower fares without lowering quality and innovation.

Divestment will weaken the ability of Scottish Citylink to compete; any divestment of any element of the current Scottish Citylink offer will put the remaining offer in an unfair weaker position against any incoming competition from a stronger National Express or similar.

Divestment dismantles the current advantages and is likely to reverse the passenger growth resultant from the current offer

Divestment will lead to reduced services and discourage innovation, as it will reverse the network advantages and wider range of fares option currently on offer.

Divestment will increase cost of operation through a combination of less efficient fleet utilisation and more expensive drivers’ duties. This will slow down the fleet replacement programme which will have an adverse impact on the mobility impaired and on environmental grounds.

The divestment remedy has halted reliability improvements and plans to improve the timetable

Non technical points arising

Some non technical questions seem to arise.

Divestment is not in the interest of the passenger.

At best, the dismantled current network will be merely substituted in part by a third party, referred to in the report but not detailed, so why is it the CC desires to at best exchange Scottish Citylink/ Stagecoach with another?

Why does the CC want to make it easier for an undisclosed third party to enjoy the fruits of the current network (which it can enter into as there are very low entry barriers), by dismantling the current operator?

Since there are low entry barriers, could not the current joint venture merely continue and compete normally, if there are such third parties interested, or is it the intention of the CC to give a third party special privileges ?

What will be with a fourth party, so to speak, are there any restrictions to be imposed on such an operator? Etc, etc.

It seems to me the consequences are not thought through, and might just leave the current joint venture for some redress for unfair restraint of trade, this is of course the thoughts of a laymen and not a lawyer.

Scottish Political issues

Other issues open up. The CC is answerable to Parliament. But responsibility for Transport is an increasingly devolved matter, through the Scottish Minister for Transport and Telecommunications.

Since the beginning of this year there is a Scottish based Executive Agency established called Transport Scotland which supports the Scottish Ministry in all Scottish Transport matters. Again, these are thoughts of a layman and not a lawyer, but does the body the CC is answerable to have jurisdiction over Scottish devolved Transport powers? If not, logically the CC report is unenforceable, and again there may be some grounds for redress.

If the CC report is enforceable, the divestment remedy appears to be in conflict with the Scottish Executives opinions, as shown in the evidence third party submissions and third part evidence. Their main concerns, if any, would appear to be with regard to investments and quality of service. If the CC had due regard for these concerns, it would not be setting a divestment remedy.

I conclude that the CC remedy is at odds with the elected Scottish opinion, in addition to the technical issues highlighted earlier. This seems sufficient grounds alone for the CC to reconsider, and abandon its divestment remedy in the face of the real technical evidence, especially with regard to future investment potential relating to mobility impaired access and environmental issues, service developments and quality improvements, and elected opinions.

A courtesy copy of these comments has been sent to Stagecoach Scotland Managing Director.

Please note I am not under any commission to make these comments. They are made from my own professional interest and concern that the divestment remedy in this case is flawed, and putting it simply, is wrong, and not in the public interest for the reasons outlined above and for future similar cases. I trust the CC members will find my comments useful, and perhaps enlightening in the context of the peculiarities of the bus industry.

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