

2 Conclusions

Contents

	<i>Page</i>
The reference	5
The regulatory and contractual framework for rail services	7
The companies	9
National Express Group PLC	9
ScotRail Railways Limited	10
Background to the merger	11
The relevant markets	11
Rail services	11
Coach services	13
The overlap between ScotRail and Citylink/NEL	14
Transport integration	15
The effects of the merger	15
The extent of competition between rail and coach services	16
Competition from other suppliers of transport services	18
Regulatory and contractual constraints on ScotRail	21
Competition between public and private transport and the overall sensitivity of the travel market	21
Assessment	22
The overlapping routes	23
The benefits of the merger	27
The effect on the public interest	28
Remedies	29

The reference

2.1. This reference, the full text of which is set out in Appendix 1.1, was made to us on 22 May 1997 under sections 64 and 69(2) of the Fair Trading Act 1973 (the Fair Trading Act). Under it we are required to investigate and report whether a merger situation qualifying for investigation has been created as a result of enterprises carried on by or under the control of NEG having ceased, within the four months preceding the date of the reference, to be distinct from enterprises carried on by or under the control of ScotRail. If we find that either the share of supply test or the assets test (referred to in section 64(1) (a) and (b) respectively) is satisfied, the reference requires us to exclude the other from our consideration.

2.2. As described in paragraph 3.65, on 21 February 1997 NEG entered into a franchise agreement for a period of seven years with the Director of Passenger Rail Franchising (the Franchising Director) and the Strathclyde Passenger Transport Executive (SPTE). NEG also acquired the issued share capital of ScotRail. In accordance with the franchise agreement NEG took over responsibility for the operation of the ScotRail services on 31 March 1997. Under section 66(3) of the Railways Act 1993 (the Railways Act) the acquisition of a passenger rail franchise is treated as the acquisition of control of an enterprise. Accordingly, for the purpose of section 65 of the Fair Trading Act, the enterprises of NEG have ceased to be distinct from the

enterprise consisting of the passenger rail franchise carried on by ScotRail. The date of the franchise agreement is less than four months before the reference was made to us.

2.3. The assets test is not satisfied because the value of assets taken over by NEG in this transaction was less than the £70 million threshold which now applies for the purpose of section 64(1)(b) of the Fair Trading Act (see paragraph 3.77).¹

2.4. As regards the share of supply test in section 64(1)(a) we are required to be satisfied that, as a result of the enterprises of NEG and ScotRail ceasing to be distinct, at least one-quarter of services of any description supplied in the UK or a substantial part of the UK is supplied by one and the same person or, if this was already the case, that the supply of the relevant services by that person is increased. Our terms of reference state that it appears to the Secretary of State that it is or may be the fact that a merger situation qualifying for investigation has been created as a result of the enterprises of NEG and ScotRail ceasing to be distinct and that the share of supply test is satisfied with respect to the supply of public transport passenger services in Scotland. 'Public transport passenger services' are defined as public transport passenger services (excluding bus services, within the meaning of section 159 of the Transport Act 1968, as amended) involving journeys of more than 50 km carried out wholly within Scotland. We are not, however, confined to considering whether the share of supply test is satisfied with respect to the supply of public transport passenger services as defined in the terms of reference—we are required to investigate and report on whether a merger situation qualifying for investigation has been created as a result of the matter described in paragraph (a) of the terms of reference, that is the enterprises of NEG and ScotRail ceasing to be distinct. Moreover section 68 of the Fair Trading Act gives the MMC a wide discretion in determining the services to which the share of supply test is applied.

2.5. We were told that the distinction between bus services—that is, for practical purposes, services which stop at least every 24 km and are registered with the Traffic Commissioner—and scheduled coach services in Scotland was an artificial one from a commercial perspective. Citylink is regarded as the principal operator of scheduled coach services in Scotland yet most of its services are registered as bus services. In addition, although the terms of reference refer to 'journeys of more than 50 kilometres' we found that transport operators were unable to provide data on this basis. Instead we have obtained estimates of the supply of transport services on routes which exceed 50 km in length. Accordingly we have applied the share of supply test to the supply of public transport passenger services, including bus services, on routes wholly within Scotland which exceed 50 km in length.

2.6. As shown in Table 4.3, we estimate that total revenue from the supply of public transport passenger services on routes wholly within Scotland which exceed 50 km in 1996 was £[*] million. NEG's share of this was 8 per cent, mainly as a result of its ownership of Citylink. The share of ScotRail (which was then in separate ownership from NEG) was 55 per cent within which SPTE-supported services accounted for 20 per cent (SPTE's role is explained in paragraph 2.13).

2.7. NEG submitted that, since the revenue from SPTE-supported services accrued to SPTE and NEG had no commercial interest in the services, that revenue should not be counted as part of NEG's supply of public transport passenger services in Scotland. We believe that it is open to us to include the revenue from SPTE services in calculating NEG's share of supply. It is in any event clear from the figures in paragraph 2.6 that, as a result of the enterprises of NEG and ScotRail ceasing to be distinct, NEG now supplies well over one-quarter of public transport

¹ScotRail does not own rolling stock or infrastructure (stations, track and so on): see paragraph 2.10.

*Figure omitted. See note on page iv.

passenger services on routes wholly within Scotland over 50 km in length and that this is true whether or not SPT services are included in NEG's share. NEG said that it had no reason to question our view that the share of supply test was satisfied.

2.8. In considering whether to regard Scotland as 'a substantial part of the UK' (see paragraph 2.4) we have had regard to the judgment of the House of Lords in the judicial review of the case of South Yorkshire Transport Ltd.¹ Their Lordships held that the words in question must on their true construction connote a part 'of such size, character and importance as to make it worth consideration for the purposes of the Act'. We have no doubt that Scotland fits this description.

2.9. For the reasons given in paragraphs 2.6 to 2.8 we conclude that the share of supply test is satisfied and that a merger situation qualifying for investigation has been created. We have therefore to consider whether the creation of this merger situation operates or may be expected to operate against the public interest. Since the merger has been completed relatively recently and its effects may not yet be fully apparent, we have concentrated on whether it may be expected to operate against the public interest.

The regulatory and contractual framework for rail services

2.10. The Railways Act brought about a major reorganization of the rail network in Great Britain, and by the General Election of 1 May 1997 nearly all the component parts of the new structure had been privatized. Twenty-five train operating companies (TOCs) operate passenger services under franchises awarded following a process of competitive bidding. They lease rolling stock from rolling stock companies (ROSCOs) and pay for rail access provided by Railtrack plc (Railtrack), from which they also lease railway stations.

2.11. All TOCs are subject to regulation by the Rail Regulator and the Franchising Director. The Rail Regulator is responsible for granting licences, for setting conditions for those licences and for enforcement of them. Different types of licence are required for the operation of the different categories of railway assets, namely a train operator's licence, station licence, light maintenance depot licence and network licence. TOCs typically need the first three in order to be able to operate. The Rail Regulator is also responsible for controlling access to the track-access agreements between Railtrack and TOCs require his approval and has functions in relation to domestic competition policy under the Fair Trading Act and the Competition Act 1980.

2.12. The Franchising Director's principal responsibilities include negotiating and awarding passenger rail franchises and monitoring the performance of the franchisees. His principal objectives, given to him by the Secretary of State for Transport in March 1994, are to secure that passenger services are provided under franchise agreements as soon as reasonably practicable and to secure an overall improvement in the quality of passenger services. In inviting tenders for franchises he sets out minimum service standards (the passenger service requirement, or PSR) and other requirements in relation to capacity and punctuality, for example which bidders must meet. The PSR specifies the routes and stations to be served, frequency, first and last trains and maximum journey times, although the degree of detail and hence the successful bidder's ability to change the service varies. Bidders have usually offered service enhancements, over and above the PSR, in their tenders: those offered by the successful bidders are incorporated in the franchise agreements and hence become commitments. The Franchising Director must also ensure that the franchise agreements contain such provisions as he considers necessary for ensuring that fares are reasonable (see paragraph 2.15). Once franchises are let he has a duty to secure compliance with the terms of the franchise agreements, to which end he has powers to make orders and, where appropriate, impose financial penalties on operators. He is also

¹*R v MMC ex parte South Yorkshire Transport Ltd*, [1993] 1 WLR, p23.

responsible for making subsidy payments to operators in accordance with the franchise agreements.¹

2.13. In relation to franchises which include the operation of local services in the main conurbations (apart from London), the role of the Franchising Director is in effect shared with the relevant Passenger Transport Executive (PTE). PTEs, which were established under the Transport Act 1968, have a duty to secure the provision of such public passenger transport services in their area of responsibility as they consider appropriate for meeting requirements, in accordance with policies formulated by the corresponding Passenger Transport Authority (PTA) whose members are drawn from elected representatives of local authorities. Where passenger rail services are to be provided under a franchise agreement within a PTE's area of responsibility, the PTE may specify, as part of the PSR, the passenger rail services which it considers appropriate to meet its obligations. Where it does so, the PTE becomes a party to the franchise agreement and is responsible for providing any financial support required for such services (as determined by the franchise tendering process). Before entering into a franchise agreement, the PTE must obtain the PTA's approval. PTEs may specify fares for rail services in their area of responsibility. In most cases, including Strathclyde, PTEs have retained complete control of fares and have chosen to take the 'revenue risk': in relation to services in those areas the franchise operator is paid a predetermined fee and passes all the revenue to the PTE. However, Greater Manchester PTE and West Yorkshire PTE have transferred revenue risk to the relevant operators in their areas.²

2.14. Outside PTE areas TOCs set the fares subject to the terms of the franchise agreements. For each flow (that is, a journey between two points on the network), a lead operator is designated, normally the TOC which provides the largest number of services on the flow. The lead operator sets fares which are 'interavailable', in that all TOCs which run services on all or part of the flow must honour tickets issued by any other operator charging those fares. TOCs may in addition set their own dedicated fares³ for the flow which are valid on their trains only. The lead operator may set dedicated fares only for first-class and advance-purchase tickets or for temporary and special fares (this is to prevent it from undermining interavailability). Income from interavailable fares is allocated between operators broadly in relation to the number of passengers travelling on each TOC's services but all income from dedicated fares is retained by the TOC which sets them.

2.15. The Franchising Director's policy in regulating fares is to constrain only particular categories of fares. Generally these include Saver fares or unrestricted standard-class return fares; weekly standard-class season ticket fares; and, within the London, Edinburgh and Cardiff areas, most season tickets plus some standard-class single fares. The particular fares to be capped vary between franchises according to circumstances. For the three years from January 1996 capped fares are pegged to the retail price index (RPI), whilst for the following four years increases are limited to RPI 1 per cent. NEG told us that, by selecting key season ticket and leisure fares for direct regulation, the Franchising Director was influencing all other fares because of the need for TOCs to retain a sensible commercial relationship between the levels of regulated and other fares.

2.16. As noted in paragraph 2.11, the Rail Regulator must approve any agreement giving access to the rail network. In accordance with guidance given by the Secretary of State for

¹Subsidy levels typically decline year by year over the period of the franchise. In a small number of cases the franchise operator has agreed to make payments to the Franchising Director, rather than receiving subsidies.

²In addition the West Midlands PTE has agreed to share revenue above a specified threshold with Central Trains Limited, the principal operator in its area.

³In practice dedicated fares are invariably lower than the corresponding interavailable fares because there would be no reason for passengers to pay more for a journey when the TOC is obliged to honour the interavailable fare.

Transport in 1994 he decided that, in order to facilitate the franchising, entry by rival TOCs seeking to provide a service competing with a service provided under a franchise should be restricted for several years (this policy is known as moderation of competition). The Rail Regulator's policy is that no significant new entry should be allowed before 1 April 1999 on flows nominated by a TOC.¹ However, a TOC which already has access rights on a particular flow is generally permitted to agree additional access rights with Railtrack, even if this is in competition with other TOCs also present on that flow. As regards the second stage of the moderation of competition, the Rail Regulator told us during the inquiry that, from 1 April 1999, new entry would be allowed on flows where there was existing competition and the restrictions on the other flows would be loosened: his current intention was that operators would be able to nominate a new list of flows and entry would be allowed up to a ceiling of 20 per cent of aggregate revenue on those flows. Existing competition on nominated flows would count towards the ceiling.

2.17. A more detailed account of the working of the new structure of the railway industry and its regulation is at Appendix 3.6.

The companies

National Express Group PLC

2.18. As described in more detail in paragraphs 3.2 to 3.9, NEG was formed in 1988 by a management buyout of the National Bus Company's (NBC's) scheduled long-distance coach service business. It became a publicly quoted company in 1992 and subsequently made acquisitions of airports, further coach activities, bus companies and TOCs; it also has a share of London and Continental Railways Limited (L&CR) which is to develop the rail link to the Channel Tunnel.

2.19. The issues arising in this reference concern the overlap² between services provided by ScotRail and by NEG's coach services, which in Scotland are operated through its subsidiaries-NEL and Citylink.

2.20. NEL provides a network of scheduled coach services under the National Express name and livery covering the whole of England and Wales and with cross-border services extending into Scotland. NEL is not itself a coach operator. It contracts with individual coach operators (many of them ex-NBC bus companies and now part of other bus groups) which, for a pre-arranged fee, provide coaches, drivers and-for certain services-stewards or hostesses. NEL runs the central marketing, ticket sales and reservations systems and establishes timetables, fares and fare structure, conditions of carriage and service quality standards. Its services link over 1,100 locations and involve over 200 routes.

2.21. In May 1993 NEG acquired Saltire Holdings Ltd (Saltire), the parent company of Citylink. That acquisition was the subject of a reference to the MMC, which reported that the merger was not against the public interest.³ Citylink, formerly part of the Scottish Bus Group (SBG), had been privatized by sale to Saltire, a management and employee buyout vehicle, in

¹A flow may be nominated if it is material to the operator, which in the case of ScotRail is defined as accounting for more than 0.13 per cent of its total revenue. The smallness of this figure reflects the large number of separate flows on ScotRail's network.

²In this report we use the term 'overlap' to refer to routes or parts of routes on which ScotRail and one or more of NEG's other subsidiaries operate services.

³*National Express Group PLC and Saltire Holdings Ltd: a report on the merger situation*, HMSO, Cm 2468, February 1994. Referred to in this report as the Saltire report.

1990. Based in Glasgow, it operates in a substantially similar way to NEL, contracting with coach operators to provide scheduled services to Citylink's specification. It operates some 340 services a day and in 1996 carried a total of 2.2 million passengers.

2.22. NEG wholly owns two bus companies in Scotland-Highland Country Buses Limited (Highland Country Buses), which operates local buses in Skye, Lochalsh, Caithness, Fort William and Aviemore; and Taybus Holdings Limited (TayBus), the main operator of urban bus services in Dundee-and has stakes of 25 per cent in two coach companies, Craig of Campbeltown Limited (which trades as West Coast Motors) and Skyeways Travel Limited.

2.23. NEG has acquired five passenger rail franchises since April 1996. Apart from ScotRail the companies concerned are Gatwick Express Limited (Gatwick Express), Midland Main Line Limited (MML), Central Trains Limited (Central Trains) and North London Railways Limited (NLR). There is no overlap between the services of any of these four TOCs and ScotRail. NEG's acquisition of MML was itself the subject of a merger reference to the MMC. In a report published in December 1996¹ the MMC concluded that the acquisition might be expected to operate against the public interest by leading, over time, to higher coach fares or higher fares on both coach and rail and/or a lower quality of coach services or a lower quality of both coach and rail services on certain routes from central London than would have otherwise been the case. The MMC recommended that these adverse effects be addressed by a set of behavioural undertakings relating to coach fares and levels of service on the routes concerned. The Secretary of State accepted this recommendation and asked the DGFT to seek undertakings from NEG accordingly. NEG's acquisition of Central Trains has also been referred to the MMC and we are reporting on that reference at the same time as on the ScotRail case.

2.24. For the year ended 31 December 1996 NEG's total turnover was £483 million (1995-£318 million) and its operating profit was £62 million (1995-£44 million). NEL made an operating profit of £7 million on turnover of £106 million for 1996. The equivalent figures for Citylink were £1.7 million and £11.3 million.

2.25. NEG told us that its management was highly decentralized in keeping with the local nature of its businesses. It operated its rail businesses on a wholly separate and independent basis from its coach business.

ScotRail Railways Limited

2.26. ScotRail is the principal operator of passenger train services in Scotland: the only other TOCs providing such services in Scotland are the three which operate cross-border services to and from England (see paragraph 2.33). ScotRail also provides services to Carlisle and Newcastle and operates Anglo-Scottish sleeper services. Many of its services in the Glasgow area are operated for SPTE which sets the fares, retains all revenues and carries the commercial risk. A map of ScotRail's network is at Figure 4.1. Its services cover some 3,000 route km-of which some 600 are in England-and call at 352 stations. Draft accounts for the year ended 31 March 1997 show ScotRail's revenues as £[*] million on which it made an operating loss of £[*] million before subsidy of £285 million. The subsidy was partly offset by £41 million of revenues which ScotRail collected on behalf of SPTE.

¹*National Express Group PLC and Midland Main Line Limited: a report on the merger situation*, The Stationery Office, Cm 3495, December 1996. Referred to in this report as the MML report.

*Figures omitted. See note on page iv.

Background to the merger

2.27. Following the issue of an information memorandum by the Franchising Director in September 1996 NEG submitted an indicative bid for the ScotRail franchise. It was one of [*] companies shortlisted and on 21 January 1997 it submitted its final bid. NEG was informed on 10 February 1997 that it had been chosen as the preferred bidder and, as noted in paragraph 2.2, it entered into the franchise agreement on 21 February 1997.

2.28. The agreement provides that NEG will receive from the Franchising Director and SPTE financial support totalling, at constant (February 1997) prices, £280 million in 1997/98, declining to £202.5 million in 2003/04.¹ In real terms the figure for 2003/04 represents a fall of 31 per cent compared with the subsidy claimed by the British Railways Board (BRB) for 1996/97 in respect of ScotRail's services. In addition to meeting the PSR, NEG is committed by the franchise agreement to provide no less than the current number of train miles annually for the life of the franchise, to provide a range of enhancements to services and stations, and to invest in new and refurbished rolling stock (see paragraph 3.70). It is also committed under its Passenger's Charter to meeting higher standards of punctuality and reliability. NEG's bid required the lowest subsidy while guaranteeing what the Franchising Director and SPTE regarded as a high level of service (see paragraphs 3.66 and 3.67).

2.29. As described in paragraphs 3.78 and 3.79, the Franchising Director had made clear to NEG during the tendering process that he would need to be satisfied that any competition issues which might arise as a result of NEG's other interests had been resolved and would not delay the award of the franchise to NEG. His concern was that he might again become involved in a reference to the MMC, as in relation to the MML franchise, the outcome of which would be uncertain. [

Details omitted. See note on page iv.

] NEG told the Franchising Director that it would be prepared to give [*] undertakings, which it expected would be broadly in line with those recommended by the MMC in the MML report which had recently been published.

2.30. After the franchise was awarded the DGFT recommended to the Secretary of State that she refer the acquisition to the MMC if NEG did not give an undertaking to divest Citylink. The Secretary of State, however, decided to refer the merger to the MMC immediately because it raised competition concerns in the market for the supply of public transport passenger services in Scotland.

The relevant markets

Rail services

2.31. ScotRail provides the following categories of service:

- (a) inter-urban services connecting Scotland's principal towns and cities;
- (b) rural services;

*Details omitted. See note on page iv.

¹SPTE will pay 54.5 per cent of total financial support over the life of the franchise. It should be noted that this element of the support will be partly offset by the revenues collected by NEG and passed on to SPTE.

- (c) urban services (excluding those within the SPTE area) mainly around Edinburgh;
- (d) urban services in the Glasgow area provided for SPTE; and
- (e) sleeper services which run overnight between London Euston and Edinburgh, Glasgow, Aberdeen, Fort William and Inverness.

2.32. In operating its services ScotRail is subject to the following main regulatory and contractual constraints:

- (a) It is required by the franchise agreement to operate services in accordance with the PSR, drawn up by the Franchising Director and SPTE, and the enhancements put forward by NEG in its tender.
- (b) Some of its fares are regulated by the Franchising Director (see paragraph 2.15). For ScotRail the categories of fares capped are Saver fares (or standard-class ordinary returns on flows where no Saver fare is available), standard-class weekly season tickets and, in the Edinburgh commuter area, all standard-class season tickets and unrestricted single and return fares. In the case of SPTE services ScotRail has no power to vary the fares, which are all set by SPTE. NEG told us that at present some 33 per cent of ScotRail's farebox revenue (excluding revenue from SPTE services) was subject to control by the Franchising Director. Cheaper fares with validity restrictions (such as SuperSaver, APEX and cheap day return) are not subject to price caps.
- (c) ScotRail's performance in complying with the franchise agreement and in meeting the standards under its Passenger's Charter is monitored by the Franchising Director and SPTE and incentive systems of rewards and penalties apply.

2.33. The other TOCs which operate passenger services in Scotland are:

- (a) Great North Eastern Railway Limited (GNER), which provides services between London and Edinburgh on the East Coast Main Line, some of which extend to Glasgow, Aberdeen or Inverness;
- (b) CrossCountry Trains Limited, which provides services between south-west England and Glasgow, Edinburgh and Aberdeen; and
- (c) West Coast Trains Limited, which provides services from London to Glasgow.

The latter two TOCs are both owned by Virgin Rail Group Ltd and we refer to either or both of them (according to the context) as Virgin. As noted in paragraph 2.16, these TOCs face no regulatory constraints on stepping up the level of their services on the flows where they already operate. They may also set dedicated fares for tickets valid on their own trains with a view to stimulating additional patronage and/or winning a higher share of existing revenue. The Rail Regulator told us that there were few, if any, infrastructure constraints that would inhibit the introduction of new services within Scotland, although the availability of rolling stock might be a constraint.

2.34. Survey information shows that, on ScotRail's routes taken together, about half of all passengers travel for leisure reasons, a quarter for getting to work or college, and the rest for business or making shopping trips (see Table 4.8).

Coach services

2.35. Until 1980 long-distance scheduled coach services in Great Britain were regulated, with a single operator holding a monopoly of services on each route. Following deregulation by the Transport Act 1980 there was initially a sharp increase in competition in coach services, including the establishment of the British Coachways Consortium of independent coach operators providing an alternative network of coach services to that of NEL's predecessor. This resulted in significant reductions in fares, and increases in the volume of coach travel, in part at the expense of rail use. Following the collapse of the consortium in 1982 there has been no sustained entry by coach operators on a significant network basis in England and Wales.

2.36. In Scotland, bus and coach services had been under the control of the SBG. Entry into longer-distance coach services after deregulation was more successful than in England and Wales, partly because the SBG reacted more slowly to competition than NEL's predecessor. Entrants included Stagecoach Holdings plc (Stagecoach) on the Aberdeen-Glasgow and London-Scotland routes and Newtons on the Inverness-Glasgow/Edinburgh routes. The SBG established a central marketing organization and common liveries (branded Citylink) for its coaches in 1983 and took over Newtons in 1985. NEG acquired the coach operations of Stagecoach in 1989 and competed with Citylink until acquiring it in 1993 (see paragraph 2.21).

2.37. NEL has a major share of the scheduled coach market in Great Britain, estimated in the Saltire report (1994) at 77 per cent (including the effect of the acquisition of Citylink), with the ten next largest operators sharing 18 per cent and the remaining operators 5 per cent. NEG did not provide us with an estimate of its current share but it told the MML inquiry that there was likely to have been only a slight reduction in its national share of the coach market since the Saltire report. Over three-quarters of NEL passengers travel for leisure reasons. Coach fares are not subject to regulation.

2.38. Citylink's operations principally comprise:

- (a) shuttle services across central Scotland, including the high-frequency service between Glasgow and Edinburgh. These accounted for 41 per cent of Citylink's passengers and [*] per cent of its revenue in 1996;
- (b) long-distance services within Scotland, which accounted for 54 per cent of passengers and [*] per cent of revenue in 1996; and
- (c) seasonal services connecting Scotland with certain seaside resorts in England, and the London Liner service between Glasgow and London, which accounted for 5 per cent of passengers and [*] per cent of revenue in 1996.

2.39. NEL provides services between points in England and Glasgow/Edinburgh, some of which extend to Perth, Dundee, Aberdeen and Inverness. The Scottish section of these services is shown in Citylink's timetable and, where possible, Citylink's services are timed to facilitate transfers to and from NEL services. NEL's revenue from journeys wholly within Scotland in 1996 was some £[*] million, which is small in relation to Citylink's (£[*] million from the services in categories (a) and (b) in paragraph 2.38).

2.40. There are some differences between NEL and Citylink, reflecting the shorter distances typical of Citylink services and the high frequency (every quarter of an hour) of its Glasgow-Edinburgh service. First, a much higher proportion of Citylink's tickets than NEL's is purchased at the time of departure and a much lower proportion is purchased from travel agents (see Table

*Figures omitted. See note on page iv.

4.6). Secondly, 72 per cent of Citylink's mileage is on services registered as local bus services, compared with 25 per cent of NEL's mileage.

2.41. NEG told us that there were in Scotland about 20 other operators of coach services over distances above 50 km. Most of these operate over shorter distances than Citylink. Those of most relevance to our inquiry are as follows:

- (a) Stagecoach provides inter-urban services, mainly under the Stagecoach Express brand, between Dundee and Edinburgh/Glasgow, between Aberdeen and Inverness, and between Ayrshire and Edinburgh/Glasgow.
- (b) FirstBus plc (FirstBus) operates on some longer routes, including Glasgow-Stirling-Dunfermline, Edinburgh-Stirling and Edinburgh to/from the border towns.
- (c) In rural areas some smaller operators operate on routes of comparable length to those of Citylink.

None of these operators has a network which comes close to matching Citylink's coverage of Scotland.

2.42. Stagecoach and FirstBus are major suppliers of local bus services in Scotland (and elsewhere). FirstBus is also a contractor to both Citylink and NEL. Stagecoach ceased being a contractor to Citylink when it took over certain routes and began to operate its own services (see paragraph 4.18) but it remains a contractor to NEL in England.

2.43. There are no regulatory barriers to entry into the coach and bus market and capital costs are relatively low. Nevertheless there has been little sustained entry into long-distance coaching in Great Britain as a whole and there is no national competitor to NEL nor, within Scotland, to Citylink. On individual routes in Scotland, however, there has been some growth of inter-urban bus services, particularly by Stagecoach (see paragraph 2.66).

The overlap between ScotRail and Citylink/NEL

2.44. There are four categories of overlap between ScotRail and NEG's other operations:

- (a) The inter-urban and rural routes of ScotRail overlap with routes served by Citylink and NEL. Table 4.10 summarizes for these routes the revenue, number of passengers and journey times of the ScotRail and Citylink/NEL services; the existence of rail or coach competition; and the frequency of operation of both NEG and other services. The data in Table 4.10 relate only to the whole route in each case because NEG was unable to provide a breakdown of Citylink's passenger numbers and revenue by point-to-point flow. These overlaps account for the majority of the coach routes of Citylink/NEL in Scotland.
- (b) One Citylink service, Gourock-Glasgow, overlaps on part of its route with one of the services which ScotRail operates for SPTE.
- (c) ScotRail and Citylink both provide services between Dunfermline and Edinburgh. The ScotRail service is one of its urban services in the Edinburgh commuter area.
- (d) ScotRail's sleeper services and coach services of both Citylink and NEL operate between Scotland and London.

There is no significant overlap between ScotRail's services and the local bus services provided by NEG's two bus companies in Scotland, Highland Country Buses and TayBus.

Transport integration

2.45. In June 1997 the Government announced a review of transport policy and on 21 August 1997 the Department of the Environment, Transport and the Regions (DETR) issued a consultation paper entitled *Developing an integrated transport policy* (see Appendix 4.2). This is to pave the way for a White Paper which is to be published in the spring of 1998. A central theme of the consultation paper was that improvements in public transport were necessary to encourage a shift from private to public transport. Better integration between different transport modes was seen as an essential element in this process. We have taken account of the consultation paper in considering the effects of the merger.

The effects of the merger

2.46. The key issues in this inquiry are:

- the extent of competition between rail and coach services;
- the extent of actual and potential competition from other providers of rail and coach/bus services;
- the effect of regulatory and contractual constraints on ScotRail; and
- whether competition from private cars or the price sensitivity of demand for rail and coach services are sufficient to prevent adverse effects arising from any loss of competition between rail and coach.

We examine each of these aspects in turn before addressing the situation on individual overlapping routes.

2.47. In considering these issues we have examined evidence obtained specifically for this inquiry and also evidence obtained for the parallel inquiry into NEG's acquisition of Central Trains (see paragraph 2.23). The issues here are substantially the same as those which arose in the inquiry into NEG's acquisition of MML (see paragraph 2.23), although the facts of the present case are quite different. We have noted the way in which that inquiry approached the issues and we believe that some of the evidence considered, being of a general nature rather than specific to particular routes or areas within Great Britain, is applicable to the present inquiry too.

The extent of competition between rail and coach services

2.48. Whether there is a possibility of competition between two types of service depends on whether they serve the same market and are therefore effective substitutes for each other. As noted in paragraph 2.34, survey evidence of ScotRail passengers shows that, taking ScotRail's network as a whole, about half of all passengers travel for leisure reasons, a quarter for getting to work or college and the rest for business or shopping. The proportion travelling for leisure reasons is much higher on ScotRail's inter-urban and, especially, rural services. Equivalent information on Citylink is available only for the Edinburgh-Glasgow route. This shows a broadly similar pattern to the overall ScotRail picture except that the proportion of passengers travelling for business reasons is much lower. The Edinburgh-Glasgow route is, however, likely to be atypical since it is easily Citylink's busiest route and has a much higher frequency than any other Citylink service. The proportion of NEL's passengers-taking its whole network, not just the cross-border services-who travel for leisure purposes is over three-quarters, and given the importance of tourism to the Scottish economy we would expect Citylink's services other than Glasgow-Edinburgh to be carrying mainly leisure passengers too. On the other hand, a much higher proportion of Citylink's services than of NEL's are registered bus services (see paragraph 2.40) and are therefore likely to cater also for shorter journeys such as commuting and shopping trips. Taking account of these various factors we believe that the possibility of competition between ScotRail and Citylink largely relates to the leisure market but also includes an element of other journey purposes, particularly on the Edinburgh-Glasgow route.

2.49. Besides the question of whether two types of transport service are used for similar journey purposes, substitutability depends on their principal characteristics, viz routes covered, timing and frequency of service, level of fares, length and reliability of journey times and other, less measurable factors such as comfort. We note that, whereas on the main inter-urban routes ScotRail's services are quicker and more expensive (though less frequent) than Citylink's, on the principal overlapping rural routes the coach services are quicker and of similar frequency, as well as cheaper (see Table 4.10). It is also the case that on some of the routes where ScotRail and Citylink serve the same places at the ends of the routes, there are significant differences in the routes taken and hence in the intermediate places served. Thus while they may compete for passengers travelling from end to end, they do not necessarily compete for some intermediate journeys. The significance of these points needs to be considered in assessing the merger's effect on individual routes (see paragraphs 2.86 to 2.103).

2.50. The MML report presented evidence of competition between rail and coach under three headings: the pricing behaviour of the two modes; surveys of passengers' reasons for choice of mode and passenger responsiveness to changes in price; and evidence of cross-price elasticities of demand.

2.51. As regards relative pricing behaviour, it was noted in the Saltire and MML reports that coach fares had to be set some 30 per cent below competing rail fares to offset the inconvenience of coach journeys. In the present inquiry we found that coach fares were between 20 and 60 per cent below ScotRail's fares (see paragraph 4.31). This applied moreover to the rural routes of Citylink and ScotRail even though Citylink's rural services are generally faster than ScotRail's.

2.52. A study of the effects of coach deregulation in the early 1980s showed that, when coach fares were cut, about half the newly-generated demand on some services in the East Midlands was from passengers transferring from rail. BRB's main response was to introduce lower fares aimed at leisure travellers, and another study suggested that the introduction of Saver tickets had attracted passengers primarily from the coach rather than the car. When BRB introduced APEX fares in the early 1990s, the number of coach passengers between London and Scotland fell sharply. (See paragraph 4.24 for further details of this evidence.) We believe that the findings of these studies are likely to be broadly relevant to the situation within Scotland.

2.53. Survey evidence, considered by the MML inquiry, of passengers' reasons for choosing coach rather than rail showed that price was a major reason. A similar picture emerges from a survey carried out for Citylink, which showed that 38 per cent of passengers (mainly on the Glasgow-Edinburgh route) had seriously considered train as an alternative and that 71 per cent considered the low price to be very important in relation to their decision to travel by coach (see paragraph 4.36). There is also evidence that a significant proportion of users of APEX rail fares would have travelled by coach had it not been for the availability of the low APEX fares (see paragraph 4.24).

2.54. As regards cross-price elasticities, a report commissioned by the MMC for the MML inquiry suggested a cross-price elasticity of coach demand with respect to rail fares of 0.3 (that is, a 10 per cent increase in rail fares would lead to a 3 per cent increase in demand for coach travel); and an elasticity of rail demand to coach prices of 0.14 (that is, a 10 per cent increase in coach fares would lead to a 1.4 per cent increase in rail demand). This report was based on general data and we believe the findings are broadly applicable to the current case, at least so far as Citylink's inter-urban routes are concerned. A survey undertaken for ScotRail (see paragraphs 4.42 and 4.46) suggested that 25 per cent of passengers on the Glasgow-Aberdeen route, and 30 per cent on the Edinburgh-Aberdeen route, would switch to bus/coach if the price of the rail journey went up 'a lot' (and that 12 per cent and 10 per cent respectively would switch if the price of the rail journey went up 'a little'). (Because respondents were not offered the option of not travelling, however, it is likely that the survey results overestimate the number of passengers that would switch.)

NEG's views

2.55. NEG submitted that, as regards the overlapping inter-urban routes, the differences between ScotRail's and Citylink's services, in terms of frequency, journey times and fares, varied considerably. Many of the faster coach journeys were similar in duration to the slower rail journeys and coach services were more frequent than rail on 7 of the 12 overlapping journeys. NEG pointed out that, notwithstanding the modest advantages offered by rail on a number of these journeys, the cheapest comparable rail fares were all at least 45 per cent more than the equivalent economy return coach fare and on many journeys were more than double. The cheapest return rail fares (usually APEX fares) were all at least 25 per cent higher than the economy return, day return or off-peak day return of Citylink, although the conditions attached to the use of APEX rail fares were considerably more restrictive than those attached to the economy return coach fare.

2.56. As regards the overlapping rural routes, rail services were typically slower and no more frequent than coach but ScotRail's cheapest return fares were considerably more expensive than Citylink's comparable fares. NEG submitted that it was not tenable to argue that ScotRail's services imposed an important competitive constraint on Citylink's rural services.

2.57. NEG drew the conclusion that there was at most only an element of competition between ScotRail's and Citylink's services on the various Scottish inter-urban and rural routes.

Assessment

2.58. No single piece of evidence can be seen as conclusive in determining the extent of competition between coach and rail services. We believe in the light of all the evidence summarized above that there is in general an element of competition between the two modes both in Great Britain as a whole and in Scotland, particularly for leisure passengers, albeit the

importance of this factor may vary from route to route. (We address the particular question of the rural routes in paragraph 2.96.) Competition between coach and rail is therefore a factor to be taken into account by management in making decisions about fares and levels of service for both coach and rail services.

2.59. To the extent that there are overlaps between routes served by ScotRail and Citylink/NEL, that element of competition has been lost as a result of the merger. In considering the implications of this loss of competition we need to address other factors which limit NEG's freedom of action.

Competition from other suppliers of transport services

Rail services

2.60. Competition from other TOCs is in principle likely to be a greater constraint on ScotRail than competition from other transport modes. As noted in paragraph 2.33, GNER and Virgin have a presence in Scotland as a result of operating cross-border services between England and Scotland. They have a sizeable share of passenger revenues on two of the overlapping routes, namely Edinburgh-Aberdeen (where they have an estimated 35 per cent of total rail revenue between them) and Edinburgh-Inverness (where GNER takes an estimated 20 per cent of rail revenue). Both GNER and Virgin operate between Edinburgh and Glasgow but they take only an estimated 5 per cent of revenue between them. Edinburgh-Glasgow is easily ScotRail's largest flow in terms of passenger revenue, Edinburgh-Aberdeen is its third largest and Edinburgh-Inverness its twentieth largest.

2.61. Given that they already operate on these routes, there are no regulatory restrictions on GNER and Virgin increasing services there. They would need to secure additional access rights from Railtrack but the Rail Regulator told us that this was unlikely to be a difficulty (see paragraph 2.33). To the extent that they have spare capacity on their existing services they also have the option of offering dedicated fares, undercutting the interavailable fares set by ScotRail (which is the lead operator on all the overlap routes) with a view to securing a greater share of patronage. New entry may be permitted up to a certain level on other routes after April 1999 under the Rail Regulator's moderation of competition arrangements but, given that ScotRail's services are heavily subsidized, new entry on a commercial basis by TOCs not already present in Scotland appears unlikely. (The Scottish Office said that it did not expect there to be meaningful competition between TOCs in Scotland during the period of the current ScotRail franchise agreement.)

2.62. NEG told us that it regarded GNER as an aggressive competitor keen to encourage customers to use its services. GNER had introduced dedicated 'Daypex' day return fares on a number of inter-urban Scottish journeys. There was also a proposal, which GNER had publicly described as very exciting, to electrify a section of line via Shotts in Lanarkshire which, if implemented, would enable GNER to cut its journey time between Glasgow and Edinburgh to 40 minutes (compared with 50 to 62 minutes for ScotRail).

2.63. GNER told us that it was a long-distance operator with limited rolling stock and, in the short term, no options to increase the number of trains available. There was therefore no spare capacity with which GNER could materially enhance its services in Scotland. Nor did it have any current intention of competing on price by introducing special fares. It intended to purchase some new rolling stock (tilting trains) and these could enable it to add one or two more services a day between Glasgow and Edinburgh, but not until 2000. GNER described the possible electrification of the Shotts line as a longer-term option which had got no further than being discussed.

2.64. Virgin told us that it had no current plans to enhance service provision significantly on the two routes where it operated.

2.65. GNER's evidence suggests that, as might be expected, it sees its Scottish operations as part of much longer, cross-border routes and will devise its business strategy in that wider context. The same is likely to be true of Virgin. Where these operators already have a significant presence, that is on the Edinburgh-Aberdeen and Edinburgh-Inverness routes, they may take opportunities to win patronage by price competition and this possibility is likely to constrain ScotRail's fares and levels of service to some degree. There seems little likelihood of a material increase in the services provided by GNER and Virgin in the short to medium term, however.

Coach and bus services

2.66. Turning to coach and bus competition, NEG faces competition from bus operators over parts of the overlapping routes, as shown in Table 4.10. Stagecoach began to introduce inter-urban bus services in Scotland in 1993. These have expanded significantly and in 1996 the services, mostly branded Stagecoach Express, carried 2.7 million passengers, more than Citylink (2.2 million). Stagecoach described its inter-urban services as extensions to its local bus infrastructure: it was not trying to run a national network of services as Citylink did. Its inter-urban services generally took longer than Citylink's because they served intermediate communities, which were often off the main road, as well as the towns and cities at the two ends of a route. The vehicles used by Stagecoach for these services were much cheaper than those serving Citylink's routes because they were designed to be comfortable for journeys of up to about an hour and a half but no more. To a lesser extent NEG also faces competition from inter-urban bus services run by FirstBus, the largest bus company both in the UK as a whole and in Scotland, which has recently introduced some new services, and from smaller operators on parts of rural routes. We consider below the extent to which these services present competition to Citylink/NEL on individual overlapping routes.

2.67. As regards potential entry, we noted in paragraph 2.43 that there are no regulatory restrictions on the ability of bus or coach operators to introduce new services in competition with Citylink/NEL. NEG submitted that barriers to entry and expansion were low for the major bus groups in Scotland. Citylink's services were sold on a 'turn-up-and-go' basis, so other operators did not require an extensive network of ticketing and sales agents in order to compete. NEG also argued that there was less interconnecting between different Citylink services than for NEL, so that the benefit of operating a network was smaller and the opportunity for competitive entry greater, although it was not able to provide quantified information in support of this contention. There was no evidence, it said, that the hypothetical threat of an aggressive response by Citylink was a deterrent to entry by the major groups, and little evidence that contractors to NEG would be reluctant to set up services in competition with it. Both Stagecoach and FirstBus had operating bases on most parts of the overlapping routes and could expand their services at very little cost should profitable opportunities arise. Access to bus/coach stations was not a problem.

2.68. NEG submitted that there was no clear distinction between Citylink's services and inter-urban bus services provided by other operators. A high proportion of Citylink's services were registered as local bus services and participated in local authority concessionary fare schemes. Even on its longer inter-urban routes many passengers travelled only short distances. Nor did NEG accept that rival operators were providing services that were essentially extensions to local bus services: for example, the Stagecoach Express service between Glasgow and Dundee took 145 minutes and that between Edinburgh and Dundee from 112 to 160 minutes. (The majority of NEG's coach services on these routes take 135 minutes and 120 minutes respectively.) Accordingly, NEG believed that the customer base of Citylink was not substantially different from that of other bus/coach operators in Scotland. The type of vehicle was not a material distinction between bus and coach services either. The coaches used by Citylink were generally

older and of a lower specification than those used by NEL, reflecting the fact that many inter-urban passengers in Scotland travelled short distances. Stagecoach Express's services used higher-quality coaches than those used by Citylink and were typically newer.

2.69. NEG therefore considered that actual and potential competition from other bus/coach operators imposed a strong competitive constraint on Citylink's services on the overlapping routes. Recent expansions by Stagecoach and FirstBus showed that this competition was not merely a theoretical possibility. NEG believed the scale of new entry would have been much greater if Citylink had not enhanced its services since 1993, increasing frequencies on inter-urban routes and developing a comprehensive network of rural routes.

2.70. We note that the position in Scotland is different in some respects from that in England, discussed in the MML report. In particular a much higher proportion of tickets for Citylink services, compared with NEL's, are sold on the bus and a much lower proportion are sold by third party agents. The distinction between bus and coach services in Scotland is blurred. It is also the case that there is more of a history of recent entry and expansion in competition with Citylink, in contrast to the position in the MML inquiry.

2.71. The importance of this competition should not be overstated, however. Although there is competition on individual stretches of route, no other company comes close to matching Citylink's network. Stagecoach told us that its strategy was to develop additional business on routes that linked areas where it had a strong local presence as a bus operator. FirstBus's route expansion appears to be part of its response to Stagecoach's latest incursion into the Glasgow bus market rather than a strategy to develop inter-urban services on a wide scale. The potential for competition from Stagecoach and FirstBus on some of the busier inter-urban flows may be a constraining factor on Citylink. There must be doubt, however, over the likelihood of competitive entry over the whole of the longer inter-urban routes, which have less affinity with local bus services, and on the less busy routes, notably those in rural areas, where the commercial opportunities are relatively small.

2.72. Although Citylink operates mainly on a 'turn-up-and-go' basis it still has significant network strengths. NEG was unable to quantify the extent to which Citylink's passengers change coaches during their journey but it drew our attention to several points on the network where interchanges were significant. Because of Citylink's operating contracts with coach owners many of the companies in the industry have little interest in operating on their own account. NEG's shareholdings in two coach operating companies on the west coast of Scotland (see paragraph 2.22) mean that those companies are not a source of potential competition to Citylink. Demand on some routes is likely to be too low to sustain more than one operator and the seasonal nature of demand is another factor which makes entry unattractive.

2.73. We believe that, while existing competition is significant on several individual stretches of route, the prospect of further new entry does not provide a strong competitive constraint on coach prices or service standards on the Citylink/NEL network as a whole. To the extent that exceptions need to be made for individual routes we deal with them below.

Air services

2.74. There are scheduled air services between the end-points on some of the main overlapping inter-urban routes, namely Glasgow/Edinburgh-Aberdeen and Glasgow/Edinburgh-Inverness. The journey time by air is much shorter than by rail. NEG said that these services were attractive to business passengers. They did not compete directly for leisure passengers because few low-priced promotional tickets were offered, but in the light of the recent

introduction of low-priced air fares between London and Scotland it seemed quite possible that such direct competition might develop in the future, particularly if leisure rail fares rose.

2.75. Some development in air fares aimed at leisure passengers cannot be ruled out, but the size of the potential market for services within Scotland would appear much smaller than the market for services between London and Scotland, and hence less attractive for commercial exploitation. It is unlikely, in our view, that this possibility would provide a significant constraint on ScotRail leisure fares. Air services between London and Scotland do, however, represent one source of competition to ScotRail's sleeper services and to Citylink's and NEL's services on London-Scotland routes (see paragraph 2.101).

Regulatory and contractual constraints on ScotRail

2.76. ScotRail is required by the franchise agreement to operate a specified minimum level of services. NEG told us that in general, on the overlapping routes, ScotRail was operating at the level of the PSR and could not therefore cut services without being in breach of the agreement. The only significant exception, it said, was on the Glasgow-Edinburgh route.

2.77. Paragraph 4.9(a) sets out differences between the PSR and ScotRail's current timetable. It shows that, with the exception of Glasgow-Edinburgh-where ScotRail could reduce the service from half-hourly to hourly in the evenings-the scope for NEG to cut costs by reducing services is very limited. Franchise commitments also restrict ScotRail's ability to reduce service quality.

2.78. In addition ScotRail is subject to the regulation by the Franchising Director of some of its fares, notably Saver fares. These fares, which are likely to be important for leisure travellers, are the cheapest fares on the rural routes and on 2 of the 12 main overlapping inter-urban flows. On other routes, however, NEG has the ability to increase APEX, SuperSaver and cheap day return fares, which are not regulated.

2.79. As regards the services which ScotRail provides for SPTE in the Glasgow area, which account for [*] of ScotRail's total passenger revenues, we noted that SPTE has laid down the minimum service requirement in detail, determines the fares and takes the revenue (see paragraphs 2.13 and 2.32). We have no concerns about the overlap between Citylink and the services which ScotRail provides for SPTE-which is, in any case, confined to one route (Glasgow-Gourock)-since NEG has no ability to manipulate competitive conditions in respect of those services.

Competition between public and private transport and the overall sensitivity of the travel market

2.80. NEG submitted that car travel was the most important source of competition to public transport in Scotland. Indeed the importance of the car was greater in Scotland than elsewhere in Great Britain because, it claimed, car ownership in most of Scotland was higher, encouraged by the relatively low accessibility of public transport in many areas and the relatively uncongested roads. The success of NEG's acquisition of ScotRail depended on it persuading car users to switch to rail travel. NEG did not, however, seek to argue that competition from the car was itself sufficient to prevent increases in rail fares if there were no other constraints on such fares.

2.81. Table 4.1 shows that, while the bulk of passenger travel in Scotland is made by private transport, the share of public transport is greater than in the rest of Great Britain. Moreover 38 per cent of Scottish households have no car, well above the UK average of 30 per cent (see

*Details omitted. See note on page iv.

Table 4.2). In some of the more rural areas of Scotland, the proportion of households with a car is similar to or slightly above the UK average but it is below the proportion found in rural areas in England. We are not, therefore, convinced that competition from the car is greater in Scotland than in the rest of Great Britain. Many users of public transport would not have cars available for their journeys (see, for example, paragraphs 4.36 and 4.42) and the issue is whether competition from the car for those who have the choice is sufficient to safeguard those who do not.

2.82. We acknowledge that, for those who have access to a car, the car is an alternative to public transport and that the ability of some passengers to switch to car travel is one factor that public transport operators have to take into account when considering the effect of price rises. Another such factor is that some passengers may prefer not to travel at all if faced with higher-priced public transport. However, we have concluded (see paragraph 2.58) that there is an element of competition between rail and coach and this conclusion remains valid even though there are other factors that affect demand for public transport (and it would indeed be surprising if there were no other such factors). The removal of this element of competition would in our view give a common owner of rail and coach services the incentive to exploit its position to some extent, for example by raising prices, and this remains the case even though there would also be some loss of patronage due to higher prices. We have taken a similar view in our parallel inquiry into NEG's acquisition of Central Trains.

2.83. NEG told us that the success of its acquisition of ScotRail was predicated on persuading car users to switch to travelling by rail and that the required growth in traffic could not be achieved by withdrawing coach services. We accept that NEG is seeking to attract passengers away from the car but note that this may be achieved by a variety of means including offers targeted at car travellers (for example, offers that allow two to four people to travel for a flat fare). In our view, the existence of NEG's plans to attract car travellers does not imply that there is not also advantage to NEG in exploiting its position to some extent as common owner of rail and coach services.

Assessment

2.84. In the light of the analysis set out in paragraphs 2.48 to 2.83 we take the view, first, that NEG would have the opportunity to raise coach prices on routes where Citylink's services overlap with ScotRail's and where competition from other rail and bus/coach operators is weak. It would also have the incentive to do so if the increase in profits which could be expected from such actions was material. Such price increases would benefit NEG by bringing a higher yield per passenger from those continuing to use the coach and by raising ScotRail's revenue to the extent that passengers switched to rail, and these benefits would not be wholly offset by the loss of patronage which could be expected to occur. Increases in coach fares could be accompanied by increases in rail fares too, although that is less likely partly because some rail fares are already high relative to coach fares given the modest advantages of ScotRail's services on some routes; partly because of the effects of regulatory control of certain rail fares; and partly because of NEG's need to boost passenger numbers on ScotRail if it is to make a financial success of the franchise. We do not believe that it would be an attractive commercial strategy in general for NEG to reduce levels and/or quality of service on either coach or rail in order to cut costs. As regards coach, it would be difficult for NEG to reduce service standards on overlapping flows without affecting other services as well, including those where it faces competition from other bus/coach operators. As regards rail, a high proportion of costs consists of rolling stock leasing and track access charges and is therefore largely fixed. There is little scope for ScotRail to cut services without breaching the PSR, and the franchise agreement contains other safeguards affecting service quality.

2.85. Secondly, our perception is that the competition which Citylink has encountered in practice from ScotRail in recent years has been relatively weak. The Saltire report noted that ScotRail made less use of price competition than InterCity and the evidence we received suggests that that situation has continued. Following the franchising of ScotRail's service we would expect to see a much more commercial approach by the management given that, on the one hand, subsidy levels are now determined for seven years in real terms and, on the other hand, the amount of subsidy will decline, putting NEG under pressure to boost revenues. If NEG did not also own Citylink, we would have expected—given the evidence of substitutability between rail and coach which we have cited—that ScotRail would see the winning of passengers from the coach network as a significant part of its strategy, and that the coach company would respond vigorously to defend its market, with a resulting downward pressure on fares and a stimulus to innovation and improved quality of service on both rail and coach. Given the common ownership, however, we do not expect vigorous competition to develop in this way and these potential benefits will be lost. There will still be incentives on NEG to offer attractive fares and improve services on ScotRail because of the pressures arising from the franchise agreement (see paragraph 2.84) but our concern is that the incentives will be diminished by the common ownership of rail and coach.

The overlapping routes

2.86. Against this background we consider the overlaps between ScotRail and Citylink/ NEL. The principal overlaps concern ScotRail's inter-urban and rural routes and are listed in Table 4.10. We take each of these in turn.

Glasgow-Edinburgh

2.87. This is the busiest route for both ScotRail and Citylink. ScotRail runs 38 services each weekday and Citylink 64. ScotRail's revenue in the latest complete year was £[*] million and Citylink's £[*] million. Both GNER and Virgin run rail services (nine GNER and two Virgin each weekday) but take only 5 per cent of total rail revenue between them. Their services are parts of much longer, cross-border routes and they follow a longer route than ScotRail between Glasgow and Edinburgh. The possibility of GNER adding one or two more services a day from 2000 (see paragraph 2.63) is not a material change compared with the present situation. Although there is a possibility of GNER's journey time being cut below ScotRail's if an electrification project proceeds, that would take some time to complete even if it goes ahead and we consider it too speculative to affect our judgment on the competitive situation. There is no competition to Citylink from other bus/coach operators.

2.88. We do not think that GNER and Virgin can be seen as presenting significant competition on this route given that their priorities must be elsewhere (neither currently offers dedicated fares on the route). Nor do we believe there is a serious risk of entry by other bus/coach operators unless Citylink's service was to deteriorate considerably and/or its fares were to be raised substantially. We expect adverse effects of the kinds specified in both paragraphs 2.84 and 2.85.

Glasgow-Aberdeen

2.89. ScotRail runs 16 services each weekday while Citylink and NEL run 19. ScotRail's revenue in the latest year was £[*] million and Citylink's was £[*] million.¹ No other TOCs

¹Route-by-route revenue figures are not available for NEL's services in Scotland. As noted in paragraph 2.39, however, NEL's total revenue from journeys wholly within Scotland in 1996 was only £[*] million.

operate except for the Dundee-Aberdeen stretch which is part of the Edinburgh-Aberdeen route (see below). There is competition from bus operators on several stretches—from Stagecoach between Glasgow and Dundee (but not intermediate points); from FirstBus between Glasgow and Stirling; from Stagecoach and FirstBus between Glasgow and Cumbernauld; and from Stagecoach and Strathclyde Scottish Omnibuses Limited (Strathclyde) on some stretches between Perth and Aberdeen—but not between the two end-points. Some of Citylink's services require a change at Perth. Most of them take substantially longer than ScotRail's services but Citylink and NEL between them run six faster services whose scheduled journey times are only about 25 per cent longer than ScotRail's.

2.90. We do not expect other TOCs to enter on this route. The extent of competition from other bus operators is clearly likely to represent some constraint on Citylink/NEL as far as individual flows are concerned—Citylink offers a special day return fare between Glasgow and Dundee in response to competition from Stagecoach—but Citylink and NEL retain some advantages. NEG told us that Perth was an important interchange for services between Glasgow/Edinburgh and Aberdeen/Inverness, allowing a greater choice of journeys with convenient connections. The journey times of the Citylink and NEL services are generally shorter than those of their competitors. Moreover there is no end-to-end competition on the flow between Glasgow and Aberdeen and we consider it unlikely, for the reason given in paragraph 2.71, that there will be significant and sustained entry on that flow. We therefore expect that NEG would be able to raise Citylink fares for the end-to-end journey and for other flows on that route for which it does not face competition from other bus/coach operators. Moreover since rail offers a substantial advantage in journey time compared with coach, there would be scope for ScotRail to target coach passengers by offering lower fares and/or improvements in service. We do not expect this to happen with the rail and coach services in common NEG ownership. We would therefore expect adverse effects of the kind described in paragraph 2.85 too.

Edinburgh-Aberdeen

2.91. ScotRail provides nine services per weekday on this route, Citylink and NEL 14. In the latest year ScotRail's revenue was £[*] million and Citylink's £[*] million. GNER runs three rail services and Virgin one as parts of cross-border services. Between them we estimate that they take about 35 per cent of total rail revenue. There is competition from bus operators on several stretches—from Stagecoach between Edinburgh and Dundee; from Stagecoach and FirstBus between Edinburgh and Dunfermline; and from Stagecoach and Strathclyde on some stretches between Perth and Aberdeen—but not between the two end-points.

2.92. We do not expect any increase in services provided by other TOCs in the short to medium term. The analysis of the importance of bus competition is as for Glasgow-Aberdeen, though it should be noted that some of Stagecoach's services between Edinburgh and Dundee are faster than Citylink's. Because of the presence of other TOCs, which would be likely to win a significant share of any passengers switching from coach to rail, we do not expect the merger to lead to a rise in coach fares on this route. Rail offers a much faster journey than coach, however, and as with Glasgow-Aberdeen we see scope for ScotRail to target coach passengers as part of a strategy to boost patronage. We do not expect this to happen with rail and coach services in common ownership, nor do we believe that competition from GNER and Virgin—on what for them is a peripheral route—will be keen enough to offset the loss of competition between NEG's

*Figures omitted. See note on page iv.

*Figures omitted. See note on page iv.

rail and coach businesses. We therefore expect adverse effects of the kind described in paragraph 2.85.

Glasgow-Inverness and Edinburgh-Inverness

2.93. We examine these two routes together because data on ScotRail's revenues are available only for the combination of the two. ScotRail runs seven services per weekday on each route. Citylink/NEL run 17 services between Glasgow and Inverness and 13 between Edinburgh and Inverness. For both ScotRail and Citylink/NEL some of these services require a change at Perth. ScotRail's revenue in the latest year from services on these routes was £[*] million and Citylink's was £[*] million. The advantage in journey time of the ScotRail services is much less than on the other routes considered so far. GNER operates one service per weekday between Edinburgh and Inverness and takes 20 per cent of the rail revenue. ScotRail is the only TOC operating between Glasgow and Inverness. There is competition from other bus operators on certain stretches—from Stagecoach and FirstBus between Glasgow and Cumbernauld and between Edinburgh and Dunfermline; from FirstBus between Glasgow and Stirling; and from Stagecoach between Perth and Pitlochry—but not between the end-points.

2.94. We do not expect any increase in services provided by other TOCs between Edinburgh and Inverness, nor any entry between Glasgow and Inverness in the short to medium term. The analysis of the importance of bus competition is as for Glasgow-Aberdeen. There is scope for Citylink to raise fares on end-to-end journeys and others on which it faces no bus/coach competition and we would expect the merger to lead to such increases. The loss of dynamic competitive benefits (see paragraph 2.85) on these routes is less than on the routes considered so far, because the rail journeys take almost as long as the coach journeys. Nevertheless we would have expected reductions in rail fares and improvements in service designed to win passengers from the coach if rail and coach were in separate ownership, and we therefore expect adverse effects of the kind described in paragraph 2.85 to a limited extent.

Glasgow-Oban and Glasgow-Fort William

2.95. Again rail data are available only for these two rural routes together. ScotRail runs three services per weekday between Glasgow and Oban and four between Glasgow and Fort William. Citylink runs four services on each route. Revenue in the latest year was £[*] million for ScotRail and £[*] million for Citylink. The journey times are similar between Glasgow and Oban but the coach is significantly faster between Glasgow and Fort William. No other TOCs operate, nor is there any competition from other bus operators.

2.96. We do not expect entry by other TOCs on these two routes, and entry by other bus operators is also unlikely given the modest level of traffic (fewer than [*] coach passengers on each route in 1996). The key issue is whether the more expensive rail services are in effective competition with the coach services despite having no advantage in journey time (indeed a disadvantage on the Fort William line). We note that, for people wishing to make either of these journeys by public transport, coach and rail are the only possible options. The coach and rail routes between Glasgow and Oban are very similar, whilst the routes between Glasgow and Fort William diverge only for the stretch between Bridge of Orchy and Fort William. Thus as regards intermediate points, as well as end-to-end journeys, the two modes serve largely the same places. We would expect, therefore, that a significant proportion of intending travellers will make an active choice between coach and rail. In doing so it is likely that they will take into account some or all of the range of factors set out in paragraph 2.49. Journey time is no doubt an important

*Figures omitted. See note on page iv.

factor but it is only one among several. In the case of these particular routes, which serve tourist areas, it is entirely plausible that travellers give a higher weighting to factors such as quality of scenery, comfort and the 'romance' of rail, and a lower weighting to journey time, compared with inter-urban routes. We note that ScotRail carried over three times as many passengers as Citylink on the two routes together in the latest year. For these reasons we are not persuaded by NEG's argument that ScotRail's services do not impose a competitive constraint on Citylink's rural services (see paragraph 2.56). If ScotRail and Citylink continued in common ownership we would expect that, given the absence of actual or potential competition, coach fares would rise.

2.97. In addition, if rail and coach were in separate ownership we would expect selective reductions in rail fares or improvements in service designed to attract passengers from coach. We therefore expect the merger to lead also to adverse effects of the kind described in paragraph 2.85.

Inverness-Thurso

2.98. ScotRail runs three services each weekday and Citylink four. Revenue in the latest year was £[*] million for ScotRail and £[*] million for Citylink. Citylink's service is faster than ScotRail's. There is bus/coach competition from Morrisons over the whole route (but only one service a day) and from Stagecoach between Inverness and Dornoch (12 services) and between Inverness and Brora (four services).

2.99. We do not foresee entry by other TOCs on this route but the existence of bus/coach competition, albeit limited, may constrain Citylink's freedom to raise fares. For this reason, whilst fares *may* rise as a result of the merger, we have no expectation that they will. We would, however, expect a loss of the dynamic benefits of rail/coach competition (see paragraph 2.85) for the same reasons as apply to the Oban and Fort William routes.

Inverness-Kyle

2.100. ScotRail runs four services per weekday and Citylink three. ScotRail's revenue was £[*] million and Citylink's £[*] million in the latest year. Citylink's service is the faster. It follows an entirely different route from ScotRail's, so that the overlap is only on end-to-end journeys. There is no competition from other TOCs or other bus/coach operators and we consider entry unlikely. The situation is similar to that on the Glasgow-Oban and Glasgow-Fort William routes, and for the same reasons as apply there (see paragraphs 2.95 to 2.97) we would expect to see detriments of both kinds arising on this route.

Other routes

2.101. There are other overlaps which should be noted:

- (a) *Scotland-London*. There is an overlap between ScotRail's one sleeper service per night and NEL's and Citylink's coach services between London and the main Scottish cities. GNER and Virgin are the principal operators of (daytime) rail services on these routes. ScotRail's share of rail revenue is only 9 per cent between London and Edinburgh and 18 per cent between London and Glasgow. Its sleeper fares are substantially higher than NEL's and Citylink's coach fares and the APEX fares of GNER and Virgin. There is also competition from low-priced air services.

*Figures omitted. See note on page iv.

- (b) *Glasgow-Stranraer*. Citylink's presence on this route is small and another company is the principal supplier of coach services.
- (c) *Glasgow-Carlisle*. The main direct rail service on this flow is provided by Virgin. ScotRail's share of revenue is only about 2 per cent.

We are satisfied that the merger raises no material concerns with relation to these routes.

Overall assessment

2.102. Our examination of individual overlapping routes may be summed up as follows:

- (a) In respect of seven routes-Glasgow-Edinburgh, Glasgow-Aberdeen, Glasgow-Inverness, Edinburgh-Inverness, Glasgow-Oban, Glasgow-Fort William and Inverness-Kyle-we expect the merger to give rise to both kinds of detriment described in paragraphs 2.84 and 2.85 to a greater or lesser extent.
- (b) In respect of the remaining two routes-Edinburgh-Aberdeen and Inverness-Thurso-we believe competition from other TOCs and/or bus/coach operators will prevent increases in coach fares. However, on both these routes-but particularly on the former, where the rail journey is considerably faster than the coach-we expect adverse effects of the kind described in paragraph 2.85.

The total revenue from these nine routes amounted to £34.4 million for ScotRail and £7.7 million for Citylink in the latest completed year.

2.103. NEG emphasized that Citylink and ScotRail were run as completely separate businesses. Each company's management determined its own marketing strategies, service levels and fares without reference to the other. The only exception would be where co-ordination was necessary in order to offer complementary services. We note, however, that the total revenue from the seven routes listed in paragraph 2.102(a)-the routes which, on our analysis, would be affected by a co-ordinated approach-amounted to some £27 million for ScotRail and £6 million for Citylink in the latest completed year. In Citylink's case this represents a large proportion (over half) of the company's total revenue in 1996. Even though much of the rail revenue arises from business travel, the fares for which are unlikely to be directly affected by the loss of competition resulting from the merger, we believe the potential gain from adopting a co-ordinated approach to pricing is such that it would not be a rational strategy for NEG to ignore it.

The benefits of the merger

2.104. NEG submitted that the merger would bring benefits to the public interest in two ways. First, its successful franchise bid would save the taxpayer some £55 million a year on average compared with BRB's claim for financial support in 1996/97, while also supplying a significantly higher quality of service. NEG was committed by the franchise agreement to improve service frequencies and stations; to invest in new rolling stock; and to achieve a higher level of punctuality and reliability. Secondly, the breadth of NEG's interests in transport services gave it a unique perspective on intermodal transport, making it well-placed to assist the Government to implement an integrated transport policy. In Scotland its ownership of Citylink and the ScotRail franchise offered it the opportunity to co-ordinate train and coach timetables in the Highlands in order to fill gaps in ScotRail's services, and it had in hand a number of initiatives and trials in

the area of co-ordinated ticketing and information. These measures displayed NEG's determination to strengthen the competition offered by public transport to the private car.

2.105. As regards the benefits to the taxpayer of NEG's franchise bid, the relevant comparison is with a bid which might have been expected to be accepted in the absence of NEG's rather than with the previous situation. In this respect we note that NEG's bid required a subsidy of some £[*] million less, in 1997 prices, than the under-bidder over the life of the franchise (see Table 3.7).

2.106. As regards transport integration, a number of third parties-including several local authorities and the Rail Users' Consultative Committee for Scotland (RUCCS)-considered that the merger offered opportunities as a result of NEG's involvement in different transport modes. We consider, however, that the opportunities of this kind are relatively modest given that Citylink's and NEL's services largely compete with, rather than complement, ScotRail's and that NEG owns bus companies in only two areas of Scotland. As regards rail and coach services, we believe that competition is more likely than co-ordination to lead to improved services and fare reductions. As regards rail and local bus services, which are more likely to be complementary, integration does not depend on common ownership, and it is likely that developments in Government policy following the White Paper will be designed to foster co-operation between independent operators.

The effect on the public interest

2.107. We have seen that Citylink is the principal provider of long-distance coach services, and ScotRail the principal operator of passenger train services, in Scotland. Citylink's services substantially overlap with ScotRail routes and offer much lower fares (see paragraphs 2.44 and 2.51). We reached the view that there is an element of competition between coach and rail services both in Great Britain as a whole and in Scotland, particularly for leisure passengers (see paragraph 2.58). This element of competition has therefore been lost with respect to the overlapping routes as a result of the merger and in order to address the implications of this we have examined other factors which limit NEG's freedom of action. Two other rail operators have a significant presence on two routes which may, given the scope for dedicated fares undercutting ScotRail, constrain ScotRail's fares and levels of service on those routes to some degree. We see little likelihood of a material increase in these competing rail services, however (see paragraph 2.65). There is also existing competition from other bus/coach operators on certain routes but the prospect of further entry does not provide a strong competitive constraint on coach prices or service standards on Citylink/NEL services which overlap with ScotRail services (see paragraph 2.73). There are regulatory constraints on ScotRail's ability to alter service levels and fares but these leave scope for increases in leisure fares other than Savers (see paragraph 2.78). We do not believe that either the alternative-for some passengers-of car travel or the overall elasticity of demand in relation to the level of rail and coach fares removes the incentive for a common owner of rail and coach services to exploit its position, for example by raising prices (see paragraphs 2.82 and 2.83).

2.108. The above analysis leads us to believe that the merger might cause detriments of two kinds: first, an increase in coach fares compared with current levels, and secondly, a loss of the more vigorous competition which we would have expected to develop had Citylink and ScotRail been in separate ownership, and which would have created downward pressure on fares and a stimulus to innovation and improved service quality (see paragraphs 2.84 and 2.85).

*Figure omitted. See note on page iv.

2.109. Given that the competitive and regulatory constraints on NEG vary, we have examined each of the principal overlapping routes in order to assess the likelihood of these effects arising. The analysis set out in paragraphs 2.86 to 2.100 shows that, while the presence of other TOCs and bus operators is a material factor on certain routes, there are no routes on which competition from other TOCs could be described as strong and (with one minor exception) no routes on which other bus/coach operators provide end-to-end competition. In these circumstances the loss of actual and potential competition resulting from the merger is important. We consider that one or both of the detriments summarized in paragraph 2.108 may be expected to arise on the nine routes discussed in paragraphs 2.86 to 2.100, as set out in paragraph 2.102. These routes accounted for some £34 million of revenue in the latest year for ScotRail and £8 million for Citylink. In Citylink's case the revenue from these routes accounted for two-thirds of its total revenue in 1996.

2.110. We do not believe that the benefits of the merger, which we discuss in paragraphs 2.104 to 2.106, outweigh the adverse effects we have identified.

2.111. We therefore conclude that, in respect of the nine services of Citylink which overlap with those of ScotRail and are discussed in paragraphs 2.86 to 2.100, the merger may be expected to lead to the adverse effects of (a) coach fares above current levels; and (b) as a result of the absence of the competition which would have been expected between coach and rail services, higher fares, a loss of innovation and a lower quality on both coach and rail services, compared with the situation that would have prevailed in the absence of this merger. These adverse effects are not in our view outweighed by the benefits of the merger. Accordingly we conclude that the merger may be expected to operate against the public interest. We are therefore required to consider what action may be taken for the purpose of remedying or preventing such adverse effects.

Remedies

2.112. In our assessment of the merger we found that there were detriments to competition on several routes where Citylink's services overlap with ScotRail's. These routes account for some two-thirds of Citylink's revenue (although a much smaller proportion of ScotRail's). Where we have found that a merger may be expected to operate against the public interest because of a loss of competition, it is desirable in principle to look for a structural remedy in order that a fully competitive situation may be restored, provided that a structural solution is available which is both practical and proportionate to the adverse effects identified. If, for example, the adverse effects could be dealt with by behavioural undertakings, a requirement for divestment might be seen as disproportionate.

2.113. We have considered whether behavioural undertakings on the lines of those recommended in the MML report (see paragraph 2.23) would be satisfactory in the present case. Such undertakings would need to apply to nine routes representing the bulk of Citylink's business. The undertakings would need to apply to all the individual flows where adverse effects may be expected, not just the end-to-end flows on the nine routes. As we have discussed (see paragraphs 2.86 to 2.100), however, there are some stretches where Citylink faces competition from other bus/coach operators and which would not therefore need to be covered by undertakings. Thus a complicated pattern would emerge whereby fares and service levels for some journeys on a given route would be subject to undertakings while conditions on other journeys on the same route were unregulated.

2.114. More fundamentally, one of the two kinds of adverse effect which we have identified concerns the loss of dynamic benefits from the vigorous competition which we would expect to develop if ScotRail and Citylink were in separate ownership. These benefits would be likely to

include downward pressure on fares, innovation in services and fare packages, and enhancement of service standards. It is not, however, possible to forecast precisely what the benefits would be. No set of undertakings could hope to reproduce these benefits; indeed it is for this kind of reason that regulation is normally seen as at best an imperfect substitute for competition.

2.115. For these reasons we do not believe that behavioural undertakings would be an adequate remedy for the adverse effects which we have identified in this case.

2.116. Turning to structural possibilities, divestment of ScotRail could in theory be regarded as a remedy since the merger concerns the acquisition of that company. The relative sizes of ScotRail and Citylink are very different, however: ScotRail's total revenue in 1996/97 (including SPTE services) was some £125 million compared with £11 million for Citylink. NEG's bid for ScotRail was significantly better than the next-best bid in terms of the financial benefit to the Exchequer. Divestment of the franchise would be highly disruptive given the complexity of the franchise agreement. SPTE, which provides a majority of the financial support for ScotRail under the franchise agreement, was opposed to this possibility (see paragraph 6.53). Other means are available to address the adverse effects identified and we consider that to require divestment of ScotRail would be both undesirable and disproportionate to the adverse effects.

2.117. As regards the divestment of Citylink, we note that, while the company's network is linked with that of NEL via cross-border services, the two businesses are managed separately. Citylink was itself acquired by NEG for some £5 million only four years ago, and while certain changes to its operations have been made since then, they are not such as to have changed the business fundamentally. The company has very low fixed assets but is well established and profitable and we see no reason why it should not be saleable. As to proportionality, we have seen that adverse effects may be expected on routes representing the majority of Citylink's revenues and that a behavioural remedy would be inadequate to deal with the adverse effects identified. We therefore consider that divestment of Citylink would be proportionate to the adverse effects which we have found.

2.118. As set out in Chapters 5 and 6, a number of third parties were opposed to a requirement being placed on NEG to divest Citylink. Among the concerns expressed were that a new owner of Citylink might not maintain the current levels of service; that Citylink's network might be broken up; that coach users in Scotland would be deprived of access to NEG's national network; that any new owner was likely to be one of the large bus companies, which might create further competition problems; and that the already competitive bus market might be destabilized. A smaller number of parties were in favour of a divestment of Citylink.

2.119. In addressing these concerns we note first the limited nature of Citylink's role, which does not include the ownership and operation of the coaches used for its services (see paragraph 2.21). We see no reason why a new owner, which would be likely to take on much of Citylink's existing management team at least in the short term, should not be able to perform this role equally well. Anyone interested in buying the business could be expected to be committed to making a success of it.

2.120. We agree it is important that the divestment should be accomplished in a way which does not damage the business and reduce the value of the services which it provides. It is likely that the sale of Citylink as a single entity would be more beneficial for this purpose than a break-up and piecemeal sale. Preservation of Citylink as an entity would safeguard the benefits of the network-such as interchange possibilities, through-ticketing and co-ordinated marketing-and would enable it to act as a competitive counterweight to ScotRail. We cannot, however, rule out that a sale in two or more parts-possibly, for example, to some of Citylink's contractors-would not also achieve these objectives.

2.121. As to the possible loss of the links to NEG's network in England and Wales, NEG told us that it would be in its commercial interests to see that Citylink's integration with the rest of the coach network was maintained even if Citylink were in separate ownership (see paragraph 7.76). We would expect a new owner or owners of Citylink to share this objective.

2.122. Regarding the concern that a sale of Citylink might be to a large bus company, creating competition problems in the Scottish bus market, this would be a matter for the DGFT to consider in approving the sale. Given the well-established nature of Citylink's business, we see no reason to expect the field of potential buyers to be unduly small.

2.123. NEG told us that it had included in its bid for ScotRail some modest commitments to do with transport integration on the assumption that it would own both ScotRail and Citylink. If it were required to divest Citylink, NEG would have to be released from these commitments. We accept this but we do not consider that the loss of these modest steps constitutes a reason not to proceed with the divestment.

2.124. It is desirable that the business should be sold relatively quickly so that it may be preserved as a strong competitive force and not weakened by uncertainty. We believe that six months is an adequate period for NEG to dispose of the business.

2.125. We therefore recommend that NEG should be required to divest Citylink within six months of the date of publication of this report to a purchaser or purchasers approved by the DGFT.

2.126. We noted that the services which NEL runs in Scotland are few in relation to Citylink's and that NEL's revenue from those services is only £[*] million (see paragraph 2.39). It is not in our view necessary, in order to remedy the adverse effects which we have identified, to require NEG to divest or stop these services. It is important, however, that NEG should not immediately be able to restore its existing presence in the Scottish coach market by expanding NEL's services. Once a new owner of Citylink had become established it might be pro-competitive for NEG to be allowed to increase its services in Scotland but any decision to permit this should be taken in the light of circumstances at the time. Accordingly we further recommend that NEG should be prevented from increasing its scheduled coach services within Scotland, unless given consent to do so by the DGFT, for the period of the current ScotRail franchise agreement.

*Figure omitted. See note on page iv.