

5 Views of Government departments, the Director of Passenger Rail Franchising and the Rail Regulator

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Introduction

5.1. In this chapter we summarize the evidence we received from the DETR, The Scottish Office, the Franchising Director, the Rail Regulator and Dr Stephen Glaister of the London School of Economics, an economic adviser to the Rail Regulator.

Department of the Environment, Transport and the Regions

5.2. The DETR said that, following the privatization of the passenger operations of the railways, its current activities included the creation of a strategic rail authority and an examination of the scope for stricter regulation of the railway industry. In the short term at least the intention underlying the Government's review of transport policy was to improve the system as it stood. It appeared unlikely that there would be any immediate reorganization at a structural level. There would be an emphasis on reducing the need for travel and on getting public transport to take a high proportion of travel.

5.3. On the question of competition between different modes of transport, the DETR stressed that some 90 per cent of all journeys were made by car. For the purpose of analysis the public transport market had to be disaggregated according to several factors including whether the journeys were local or inter-urban, the reasons for travel, whether passengers had access to a car and passengers' socio-economic grouping. For business travel, rail and air were the main competitors to the car, but for leisure travel the choice of modes also included the coach. Competition between rail and coach, however, affected only a narrow part of the market.

5.4. The DETR believed that the competition detriments likely to arise from common ownership of overlapping coach and rail operations were often overstated. The domination of the private car on most routes within the UK posed a significant competitive challenge to both public transport modes. The DETR was not aware of any clear evidence that a dominant supplier of coach and rail services in a particular corridor would be able or willing to maximize revenues by effecting a deliberate shift of passengers from coach to rail—a shift which could be achieved through a policy of increasing coach fares and/or reducing the frequency and quality of services. In the DETR's view an operator like NEG would find it difficult to pursue such a strategy with any success, particularly given the high price elasticity of demand for leisure travel. NEG's national brand image could well suffer as its services became less

attractive on particular routes, and it might well lose revenue as potential passengers decided either not to travel at all or to travel by car instead of by coach or train.

5.5. The DETR accepted, on balance, that overlaps between inter-urban coach and rail services could nevertheless give rise to potential competition detriments, particularly for those coach users in the leisure market who did not have access to a private car. It noted that although NEG was not entirely insulated from competition it did enjoy a significant market share on a number of inter-urban routes in Scotland. The Office of Fair Trading (OFT) had identified several long-distance routes between major cities (Glasgow-Aberdeen, Edinburgh-Glasgow, Edinburgh-Aberdeen) on which NEG was facing little or no competitive challenge from other coach operators, whatever the *potential* threat in what could be seen as a contestable market. The main competitive threat to NEG's dominance on those routes came from rival train operators, particularly GNER, but ScotRail remained the dominant provider of rail services in Scotland. It seemed unlikely that NEG would run down Citylink coach services but it might pursue an alternative strategy of gradually increasing fares on coach services. It would, however, need to be confident that it would not face competition from other operators. Such evidence as there was suggested that in the coach market barriers to entry were not insurmountable; other operators had been able to challenge NEG successfully. Potential competition from Stagecoach and FirstBus could therefore be seen as constraining NEG's behaviour on overlapping routes. They would perhaps be more likely to compete against NEG within Scotland, where Citylink tended to operate services on a 'turn-up-and-go' basis, rather than on cross-border routes run as part of the NEL network.

5.6. Commenting on public transport integration, the DETR told us that it was too soon to be clear about whether common ownership of different modes of transport within a particular area was beneficial to the public. Such initiatives as had occurred, for example in joint marketing and in information provision, had been small and localized and it was not clear whether the advantages arising from closer integration depended on common ownership or if they could be achieved without it. Any synergy between bus and rail had not been a criterion in awarding the franchises and the DETR considered that the issue of ownership was probably not central to achieving integration of transport. It was more important to examine initiatives which seemed worth promoting and then to look at the mechanisms for providing incentives for transport operators to put these in place. There had been some experiments between bus and train companies in separate ownership and if any of these initiatives was successful in generating significant additional travel, especially in off-peak periods, operators elsewhere might be encouraged to follow. At the moment it remained to be seen to what extent they were self-financing.

5.7. The evidence of NEG's performance as a train operator was that it was among the more dynamic and committed of the franchisees, for example in terms of placing orders for new rolling stock as a means of investing to increase passenger use. Although NEG did not directly run coach services, it procured network services, operated a UK-wide ticketing agency and regulated by strict specification the services of the operators with which it contracted. There were no problems and very few complaints about the way the service was run.

5.8. If the MMC concluded that the merger operated, or might be expected to operate, against the public interest, the DETR would be opposed to structural remedies which it considered could harm the interests of coach and/or rail users in Scotland. It commented that if NEG were to be required to sell its Citylink business there could be no guarantee that a successor operator would maintain the current frequency and quality of service or levels of fares, and coach users in Scotland would be deprived of access to the national network benefits which NEG alone offered. The DETR considered that a requirement on NEG to divest itself of the ScotRail franchise would be disproportionate to any detriments that might result from the merger. In support of that view, it commented that ScotRail's total turnover was around £130 million (excluding Government grant) whereas the total turnover on the routes identified by the OFT as giving cause for concern was only about £9 million. The divestment of ScotRail would also be detrimental to the interests of public transport users because there could be no guarantee that a successor operator could be found on anything like the same terms as NEG was contracted to provide.

5.9. The DETR believed that any competition detriments arising from the merger would be best dealt with by securing undertakings from NEG to safeguard existing coach fares, frequencies and standards of service for the duration of the ScotRail franchise in order to protect the interests of coach users and minimize the need for future regulation.

The Scottish Office

Competition in the passenger transport market

5.10. The Scottish Office tended to think that the relevant market for the inquiry was the supply of public transport leisure services on certain point-to-point routes. The majority of coach passengers within Scotland were likely to be leisure travellers; however, The Scottish Office suggested that reliance on coach and bus services for commuting might be fairly pronounced in Scotland because, outside the Glasgow area, the suburban rail networks around Scottish cities were limited. The disadvantage of commuting by coach, as opposed to train, was traffic congestion at peak hours on key routes, notably to the west of Edinburgh and through the centre of Glasgow.

5.11. There was probably some competition between coach and train services on the route between Edinburgh and Glasgow, although commuters and others who travelled regularly were unlikely to switch modes readily. The dispersal of population from city centres had, however, resulted in commuters travelling from a wider range of start points, from some of which coach services were more of a genuine competitor to the train. On other routes, for example in the north and north-west of Scotland, coach travel offered more powerful competition to rail travel, being both cheaper and faster. The Scottish Office commented, however, that journey time by train was likely to be more reliable across the day than journey time by road, which would fluctuate according to the degree of traffic congestion. The Scottish Office had seen no evidence to suggest that the pricing of train services was in any way affected by the pricing of coach services or vice versa. It expected that the privatization of passenger rail services would result in greater price flexibility. There was already some evidence of this with regard to special offers for long-distance rail travel.

5.12. The Scottish Office did not believe that there was any significant competition between TOCs within Scotland. It thought that greater product differentiation might develop over the next few years but it did not expect there to be meaningful competition during the period of the current ScotRail franchise agreement.

5.13. In the far north of Scotland and in the islands there was considerable reliance on scheduled air services, which tended to be used like bus or train services elsewhere. They overlapped with ScotRail or Citylink only very marginally. Air services were also used for some commuter or business journeys between Glasgow and Aberdeen, but the passengers concerned would not contemplate travel by coach as an alternative. The Scottish Office believed, therefore, that air services were not a material consideration in our inquiry.

The effects of the merger

5.14. In The Scottish Office's view, there was no reason to believe that NEG's acquisition of ScotRail would result in any deterioration in passenger rail services. The PSR at the core of the franchise agreement afforded protection to consumers through regulation of the provision of services and control over increases to some fares. The agreement was itself subject to specific statutory provisions under the Railways Act. In these circumstances, there seemed no need for the MMC to recommend remedial action with regard to the provision of services by ScotRail.

5.15. The Scottish Office's impression was that Citylink operated reliable, good-quality services at affordable prices. Its main concern was that, as a result of the merger, NEG might choose to run down Citylink services on certain routes where they had been in direct competition with ScotRail, in order to encourage passengers to switch to rail journeys. The deterioration in Citylink services might take the form of higher fares, fewer journeys or poorer quality in terms of vehicle and/or route. The future of services on the strategically important route between Edinburgh and Glasgow potentially gave rise to the greatest concerns. There were, however, factors that might reduce the incentive for NEG to run down coach services.

5.16. First, if Citylink services became less attractive, not all passengers would automatically switch to the train. Some might forgo journeys they would otherwise have made whilst others would travel by car, which was an attractive option on most of the Scottish trunk road network, where journey times had improved significantly in recent years. Increased use of the car would, however, be a cause for concern in that it would limit the options for developing an integrated transport policy. Given the Government's commitment to such a policy, it could be argued that common ownership of bus/coach and rail services might in some instances offer benefits to the public by making public transport a stronger competitor to the car.

5.17. Secondly, Citylink would run the risk of entry to the market by other operators. The Scottish Office commented that there were few coach routes of over 50 km on which there was head-to-head competition between operators and that where such competition occurred it tended to be intense and unsustainable for more than a short period. In the longer term, the market tended to settle down with a single operator. The competitive stimulus to maintaining standards tended to be provided by the threat of entry rather than the actuality. This threat was likely to come from Stagecoach and FirstBus. Smaller operators might find it difficult to set up in competition with Citylink on more than a very limited scale, particularly if they were subcontracted to supply Citylink services.

5.18. Thirdly, it would be in NEG's interests to demonstrate its commitment to its customers on Citylink as well as ScotRail services. It would be a logical business decision for it to do nothing, in the short to medium term at least, which was clearly contrary to the interests of customers that it had served for some years.

Remedies

5.19. Commenting on possible remedies, The Scottish Office said that if divestment were to be recommended then it should be partial, restricted to those routes where there was a serious risk that coach services would otherwise deteriorate. The drawback would be a reduction in the benefits of a national coach network across Scotland. The main attraction of any divestment option was that it would remove the potential conflict of interest between NEG's bus/coach and rail services. Divestment would not in itself, however, ensure that coach services neither deteriorated nor became more expensive. That would depend on there being a suitable buyer, capable of matching the level of service that Citylink might be expected to provide even given NEG's interest in ScotRail. It was possible that an existing bus operator would come forward, but that might raise other competition concerns about concentration of the provision of bus/coach services in Scotland. There would be a danger that divestment by NEG to address the lack of competition between coach and rail services might lead to an even greater threat to competition in the bus/coach market by a monopolistic operator across a large part of Scotland.

5.20. The Scottish Office's preference was for watertight behavioural undertakings to ensure that a certain minimum standard of coach service was maintained. Undertakings might, for example, specify maximum fare levels and/or minimum numbers of journeys on particular routes. The main drawbacks would be the resource implications for enforcement and monitoring and the possible difficulty involved in acquiring the information necessary to ensure that the behavioural requirements imposed on Citylink were reasonable. The Scottish Office thought undertakings for the duration of the franchise period would be an excessive remedy and believed that undertakings of a shorter duration might offer a sufficient balance between consumer protection and sensible enforcement.

Director of Passenger Rail Franchising

The franchising process

5.21. The Franchising Director described the franchising process, which had started with the issue of a pre-qualification document calling for expressions of interest. The Franchising Director had then assessed potential bidders' financial and managerial ability to run a rail franchise and had issued an invitation to tender to those judged to be pre-qualified bidders. In most cases indicative bids had been called for and a shortlist of three or four companies drawn up, from which final bids had been invited. The key number in all bids had been the level of subsidy required over the period of the franchise or, in a few cases, the premium that the bidder would pay. Bidders had been given no indication of the level of subsidy for which the Franchising Director was looking, although the indicative bid stage had been used to suggest to them where they might consider improving their bids in terms of value for money. The Franchising Director had taken a clear view from the outset that once final bids had been submitted there would be no negotiations about the level of subsidy.

5.22. The aim of the franchising programme had been primarily to promote competition *for* the market. Competition *within* the passenger rail market was the concern of the Rail Regulator, who had been consulted by the Franchising Director during the letting process. As far as competition between modes was concerned, the locus was primarily with the DGFT and it had always been the Franchising Director's practice to advise bidders to seek guidance from the OFT. The Franchising Director had had little discretion at first to take account of wider competition issues but after the NEG/MML inquiry he had been instructed by the Secretary of State to take into account any Government policies which were relevant to the provision of passenger services, and these included competition considerations. In the purely hypothetical circumstances of the best bid for a rail franchise having given rise to serious competition concerns, the Franchising Director would have had to make a judgment on whether to award the franchise to the best bidder or the under-bidder. He had not been required to make such a judgment in the case of the ScotRail franchise because final bids had been submitted before the Government announced its intention that, should the franchise be awarded to Stagecoach, the acquisition would be referred to the MMC. It had been clear at that time that NEG's was the best bid, by some way.

5.23. The franchise agreements provided significant protection for the interests of passengers. The TOCs had to run, as a minimum, the level of service specified in the PSR and were bound in to fares regulation for the duration of the franchise on certain ticket types which the Franchising Director judged would provide the right balance between, on the one hand, allowing market flexibility and innovation and, on the other hand, protecting customers. The agreements also included provisions, as appropriate, about capacity or load factors and about other matters such as standards at stations.

5.24. The Franchising Director had an ongoing responsibility to ensure that TOCs complied with the obligations contained in the franchise agreements, in particular that service improvements and other commitments were provided within the agreed timescales and that performance standards were met. Monitoring was carried out by franchise managers in OPRAF, who were in close contact with the TOCs. There were in addition quantitative systems that routinely generated performance details of each franchise-in terms of punctuality, reliability and capacity-and checks of compliance with the fares regulation system. There would be a twice-yearly audit of compliance with the franchise agreement, supplemented by specific audits where appropriate. The Franchising Director's initial response to unsatisfactory performance would be informal discussion with the TOC concerned. If that did not resolve the matter, there were various stages of formal procedure, culminating in the TOC being declared in default of the franchise agreement. The Franchising Director was empowered by section 55 of the Railways Act to initiate enforcement action.

Competition in the passenger transport market

5.25. The many difficult issues raised by rail-to-rail competition were primarily the responsibility of the Rail Regulator although opportunities for competition were currently constrained by his moderation of the potential entry of TOCs into new markets.

5.26. The Franchising Director considered that the segments of the UK travel market served by railways were largely different from those served by coaches and buses but there might be competition in some corridors between coach and rail for leisure passengers and for those primarily concerned about low fares. For short journeys, coaches and buses sometimes competed effectively with local trains. He believed that the deregulated coach market generally afforded protection to consumers in the event of an incumbent coach operator seeking to raise fares or reduce the quality of service. This was because the costs of entry to and exit from the market were low. The dominance of NEG did not in itself falsify that view. As NEG subcontracted its coach services there was already the capacity to fill any gap in a market it might vacate. The Franchising Director accepted, however, that there were network benefits from a national operation that might be endangered if NEG were to withdraw from part of its existing services. He believed that the joint ownership of rail and bus/coach operations could provide useful synergies for customers arising, for example, from integration of services and provision of information.

5.27. Passenger travel in the UK was dominated by the private car, with some 85 per cent of passenger mileage accounted for by the car and some 5 per cent each by rail and bus/coach. A merger between a bus or coach operator and a rail franchisee would, therefore, account for a very small proportion of the total travel market in the relevant area. In the case of the NEG/ScotRail merger, analysis by the OFT had indicated that the annual revenue on the NEG coach routes that overlapped with ScotRail services amounted to some £17 million—a small percentage of the Scottish public transport market.

5.28. The Franchising Director understood the concern that some groups of customers (usually identified as the relatively poor or those without access to a car for discretionary travel) might be open to exploitation if competition between coach and rail services was reduced. He believed, however, that the interests of those groups was protected far more than was generally acknowledged. The ability of an operator to discriminate between different segments of its market depended on there not being sufficient customers prepared to switch to car. In the case of rail services, for example, the issue would be whether, if fares were increased, passengers would switch to car in sufficient numbers to make the fare increase unattractive to the operator. If that were so, passengers without access to a car would be protected by the non-captive customers' ability to switch modes, because the operator would be unable to discriminate between customers when setting fares or the quality of service. In order to retain its non-captive customers it would need to offer the same standards to all customers. The Franchising Director pointed out that there was some survey evidence that many coach passengers (approximately one-third in one survey) stated that the car was their alternative mode of transport.

The effects of the merger

5.29. The Franchising Director thought that if NEG decided to increase fares or reduce quality on Citylink services in order to push passengers towards ScotRail services then other large bus/coach operators would step in to provide competing coach services. Stagecoach and FirstBus were major bus operators in Scotland and were already well represented on some of NEG's routes, thus providing a source of potential competition.

5.30. Commenting on the award of the ScotRail franchise, the Franchising Director said that there were good public interest arguments to set against any competition concerns. NEG had submitted the cheapest compliant bid [*]. Whereas British Rail had received subsidy of some £293 million for the most recent available period, the cost to the taxpayer of the NEG/ScotRail deal would fall to some £200 million by 2003/04, with reductions in support in each year of the franchise. Under the terms of the franchise agreement, NEG had given a number of far-reaching guarantees which would protect and enhance passenger rail services in Scotland. About 57 per cent of ScotRail's passenger revenue was subject to control by SPTE and the Franchising Director. SPTE had been involved at all stages in selecting the winning bid and was a co-signatory of the franchise agreement.

5.31. The Franchising Director had no immediate concerns about NEG's management of its five rail franchises. It had set up a separate trains division and it appeared that, as a group, it was highly

*Details omitted. See note on page iv.

devolved, with each business run as a separate unit. The Franchising Director required all franchisees to ensure that the rail businesses could be handed back or sold as distinct units. Any action to blur that distinction would be unacceptable.

Remedies

5.32. In the event of an adverse public interest finding, the Franchising Director believed that behavioural undertakings, rather than divestment of Citylink, would probably be sufficient to meet the competition concerns raised by the merger.

The Rail Regulator

Competition between TOCs

5.33. The Rail Regulator told us that the franchising process had gone well. Besides the reduction in subsidy, passenger numbers had, on average, increased faster than general economic growth, although it was too early to say whether this was a direct result of franchising. The car was the main competitor to rail and there was no doubt that in some cases rail routes had attracted passengers from congested parallel road routes. There were examples of TOCs using special offers to promote rail travel as an alternative to the car.

5.34. The introduction of on-rail competition would bring benefits for customers. The Rail Regulator accepted, however, that immediate unrestrained on-rail competition between existing TOCs and new entrants could frustrate the benefits of the franchising process, to the detriment of rail users. This had led him to seek to promote competition where new services would bring benefits to rail users, while at the same time moderating on-rail competition where necessary in order to facilitate franchising. In essence no material new competitive services would be able to operate until 1 April 1999, and from then until 31 March 2002 (when the policy would be reviewed) new competition would be limited to 20 per cent of a TOC's core business flows, by revenue. This threshold would take into account existing competition, which might already be at this level or greater. However, in order to make certain that consumer interests were best served, he had ensured that any pre-existing competition between TOCs had been preserved and that TOCs which already operated services in competition with other TOCs could increase services subject to securing the necessary additional track access agreements from Railtrack.

5.35. Where two or more franchises had come under common control the Rail Regulator had been keen to ensure that the opportunities for competition that existed under separate ownership were not lost. Each case had been evaluated and some point-to-point flows that were previously protected from new entry had lost that protection where the only significant on-rail competition had been provided by another TOC which came under the same ownership.

Management of rail franchises under common control

5.36. Under the terms of the franchise agreements NEG, like other companies controlling multiple franchises, had to maintain the separate TOCs as distinct entities. There were controls within the agreements over the extent to which different activities could be integrated. It was clearly envisaged by NEG and others controlling more than one franchise that there would be benefits from carrying out some functions at the group level. The Rail Regulator had proposed that there should be licence modifications to ring-fence the individual TOCs and ensure that if, for example, some activities were provided at a group level, it would be on an arm's length basis with no cross-subsidization. He believed that the modifications he was seeking, together with the terms of the franchising agreements, would reinforce the maintenance of the individual TOCs as separate business units.

Competition between rail and other modes

5.37. Given that competition between TOCs had been moderated, it was particularly important that incentives from competition with other modes were, as a minimum, preserved at existing levels in order to protect the interests of rail users. Where franchises were awarded to companies also operating bus and coach services, the central issue was the balance between, on the one hand, the desire to create the most advantageous competitive environment and, on the other hand, the benefits for rail users generated directly by the franchising process and opportunities for enhancing services subsequently. In particular, where a franchisee also controlled local bus services, it was recognized that there would be scope to co-ordinate bus and rail services, moving towards an integrated public transport system.

5.38. PTEs were interested in increasing the use of public transport in their areas. They had played significant roles in the franchise awards and had possibly been able to achieve more in transport integration than was the case previously. Outside their jurisdiction, one of the factors in which the Rail Regulator was interested was better intermodal links and co-ordination of rail and bus services.

5.39. Competition, or the threat of it, would provide the maximum incentive for TOCs to reduce prices and to deliver innovative consumer benefits. This argument applied equally to competition with other modes, such as coach or bus. However, in some cases, the control of fares and service frequencies exercised by a PTE limited the degree to which competition from other modes could influence the benefits enjoyed by rail users, because PTEs set fares and frequencies on the basis of transport policies rather than simply by economic incentives. With current levels of funding it was unlikely that any competitive action by bus or coach operators would lead to rail users enjoying either lower prices or improved frequencies on PTE-supported services.

Passenger demand

5.40. The Rail Regulator told us that passenger demand depended on several factors. The franchising process had led to changes in the way it was forecast but there were uncertainties in how competition would develop. Price elasticity varied with type of travel and tended to be higher for leisure travellers than for business or commuting. Quality of service was critical as a means of competing with the car.

5.41. There were few, if any, infrastructure constraints in Scotland but the availability of suitable rolling stock was relatively limited in the short term and this could act as a constraint on the development of new services. The extent to which new train deliveries and the renegotiation of existing rolling stock leases would relax this constraint towards the end of the decade was not yet clear. The use of price to influence demand therefore meant that TOCs had to plan ahead to meet changing circumstances and, in a structure which was becoming market-driven, had to strive for revenue increases to meet the targets set by their franchise agreements.

Competition to ScotRail

5.42. There was on-rail competition to ScotRail, or the threat of it, from other TOCs for the large majority of the inter-urban markets. Competing coach services were provided by NEG and other operators on a number of the inter-urban routes. Evidence suggested that consumers could be divided into three groups in terms of choice of mode of travel: those who chose between car and train; those who chose between coach and train; and those who chose between not travelling and train. ScotRail had traditionally competed in the last two of those market segments on both price and quality. There were, however, some markets where all three modes competed for business, for example the commuter market between Glasgow and Edinburgh.

5.43. The Rail Regulator believed that the existence of other incumbent TOCs with rights to bid for additional services (that is, to seek additional track access from Railtrack) and to introduce dedicated fares would constrain ScotRail in setting interavailable fares and associated levels and quality of service, since there would be an incentive for the other TOCs to exploit commercial opportunities arising from any significant increase in such fares or reduction in the quality of service.

5.44. ScotRail was currently protected from competitive new entry (that is, from TOCs other than those already operating on the routes concerned) on approximately 150 point-to-point flows which accounted for some 50 per cent of total farebox revenue. The Rail Regulator told us that no single flow would be exempt from potential new competition from April 1999. He expected that ScotRail would provide commercially incentivized services on the flows in question in response to the increased scope for competition.

5.45. In the Rail Regulator's opinion, the pressures generated by a competing bus or coach operator would have an impact on the actions of TOCs where there was no threat of competitive action by another TOC, but such competition might not affect all segments of a TOC's market. For example, the business market faced intermodal competition primarily from cars and airlines, and few long-distance commuters on the inter-urban routes served by ScotRail would consider coach or bus travel as a practical alternative.

The effects of the merger

5.46. Previous MMC conclusions had supported the view that coach/bus services competed with rail in the part of the leisure and commuting markets where the user did not have access to a car. The MMC had also concluded that commercial incentives would be significantly reduced where both coach and rail operator were part of the same company if there were also barriers to entry in the coach market. The Rail Regulator commented that it was difficult to estimate with confidence the precise effect of competition between coach and rail, or indeed the absence of it, but there was potential for coach operators to generate competitive incentives for ScotRail in inter-urban markets where there were no competing rail operators. In such a contestable market, it would be sound business sense for NEG to avoid abusing its position since abuse would be likely to lead to new entry and loss of its market share.

5.47. In total, the flows on which ScotRail was protected from effective on-rail competition and where coach competition was affected by common ownership by NEG accounted for approximately £5 million, or 5 per cent, of ScotRail's total farebox revenue. The market between Glasgow and Edinburgh was the most significant by far of the flows where NEG provided competing coach services and ScotRail faced the threat of the current low levels of on-rail competition being increased. Were this market solely a leisure market, the Rail Regulator would not be satisfied that the threat of increased competition from Virgin and GNER would provide adequate commercial incentives. Evidence suggested, however, that that particular flow served the commuter and business markets as well. He commented that any apparent delay by GNER in competing vigorously for the Edinburgh and Glasgow commuter market probably reflected its desire to concentrate initially on its core business of providing services between England and Scotland. He would expect GNER to compete for the commuter market in a manner consistent with its overall business objectives and not at the expense of its longer-distance travellers. He understood that the case for electrifying the Glasgow-Edinburgh route via Shotts was under consideration, with a view to redirecting the existing GNER services along that potentially faster route.

5.48. The Rail Regulator questioned whether there was any evidence that fares, frequency or quality of service on the Glasgow-Edinburgh flow had been affected by any actions of Citylink. He believed that the combination of competition from the car for commuter and business travel and the threat of increasing competition from other TOCs would go some way to minimize the potential detriments that might otherwise be suffered by rail users as a result of the merger.

5.49. The Rail Regulator believed that the merger would not result in any significant detriments for rail users within the SPTE area because fares and frequencies were set by the PTE on the basis of transport policies rather than simply by economic incentives. Common ownership in this case might enhance the opportunities for co-operation between the two modes in a way that would lead to improved co-ordination of bus and rail services, thereby providing positive benefits for passengers.

5.50. The sleeper services operated by ScotRail competed in the leisure and business markets between London and Scotland. For leisure passengers without access to a private car, competition was provided by NEG coach services and daytime rail services operated by Virgin West Coast, GNER and, to a lesser degree, Virgin CrossCountry. The competing train operators all provided discounted tickets, often reservation-specific, which were designed to compete for this market. The Rail Regulator believed that the availability of those products would ensure that any loss of competition between ScotRail and the NEG coach operations would not greatly change the competitive position and was therefore unlikely to

result in any significant detriments for rail passengers. Common ownership of coach and sleeper services would not affect the business market, which was primarily served by airlines and daytime rail services. NEG's coach operations did not compete in that market.

5.51. The Rail Regulator concluded that in the case of ScotRail there were only a few instances where the loss of competition between coach and rail could be expected to lead to detriments for rail users. They accounted for a low percentage of ScotRail's total business and of the total market as defined in the reference to the MMC. In view of this and of the service benefits to which NEG was committed by the ScotRail franchise agreement, there was no reason to believe that the merger might be expected to operate against the public interest.

Remedies

5.52. Should the MMC find the merger to be against the public interest, then structural remedies would be preferable to behavioural remedies. In looking at possible divestment, however, the MMC should give serious consideration to the interests of Strathclyde Passenger Transport Authority (SPTA) and the passengers it served. SPTA was in partnership with ScotRail and had been closely involved in the bidding process for the rail franchise. A very significant part of ScotRail's turnover was funded through SPTA's operations. The divestment of Citylink appeared to be feasible, but were the MMC to decide that that would not be in the public interest, then the Rail Regulator would support behavioural undertakings that required NEG to meet certain objectives intended to increase the use of public transport as against private transport. It was possible that the RUCCS could be involved in monitoring as far as rail services were concerned. The sanction would be a further reference to the MMC under the Fair Trading Act but another possibility was that information about NEG's performance against the objectives could be used to assist the Franchising Director when franchises came up for renewal.

Dr Stephen Glaister, Department of Geography, London School of Economics

5.53. Dr Glaister is Cassel Reader in Economic Geography at the London School of Economics. He is a consultant and a non-executive member of the Council at the Office of the Rail Regulator and was a full member of the board of London Transport between 1984 and 1993. Dr Glaister accompanied the Rail Regulator to a hearing at which he presented the following views, which are shared by the Rail Regulator.

The importance of integration

5.54. Dr Glaister told us that in the context of transport policy the public frequently used the terms 'co-ordination' and 'integration', either interchangeably or together, and with a variety of meanings. 'Co-ordinated and integrated public transport' was often used as shorthand for cheap, highly subsidized public transport, but there were more substantive interpretations of the phrase.

5.55. Within densely populated urban areas travellers often made complicated trips involving several mode changes. Integration could mean improving the layout of interchange points, optimizing the timetables (co-ordination), making information readily available and ensuring that tickets were either interavailable or common. Travel cards facilitated travel because they dispensed with the need for cash transactions at each stage and made complex and frequent trips cheaper. Dr Glaister said that the Rail Regulator recognized the benefits of these measures. Integration could also mean the bringing together of different strands of public policy, for example land use planning and public transport.

5.56. Since the 1930s there had been a controversy about public intervention in normal commercial activity in transport. It could be argued that, if passengers benefited from co-ordination and integration, they should be willing to pay and the operators should be left to provide the facilities. There were counter-arguments, namely that no sub-group of operators could on its own capture the system-wide benefits of integration; opportunities for monopoly exploitation outweighed commercial benefits of co-operation; administrative costs of co-ordination to operators might outweigh the cash benefits; and operators would be too short-sighted and incompetent to see their common advantage. There had been

suggestions that the introduction of joint ticketing might be an attempt to establish agreements restricting competition. Interavailable season tickets could include bulk discounts, loyalty bonuses, product bundling, revenue pooling and the establishment of a cartel which raised barriers to entry.

5.57. There was therefore a tension between the desire to promote inter- and intramodal competition as a means of protecting user interests and the desire to interfere with competitive outcomes to secure the public interest in co-ordination and integration. This was analogous with the tensions which faced the Rail Regulator on rail matters. It was legitimate for local authorities to strike a balance, as they did, subject to scrutiny by competition authorities.

5.58. Under the Road Traffic Act 1930 local authorities used the system of bus route service licensing to influence fares and restrict competition so that they could cross-subsidize routes to fund what they judged to be important public service obligations. The philosophy underlying the Transport Act 1985 was that this had restricted competition against the public interest. The Government of the day considered that commercially-worthwhile integration would evolve in a free market and should be judged under normal competition law.

5.59. In contrast to the position under bus deregulation, PTAs had managed to keep a significant degree of control over local rail services, latterly through the franchise agreements. While many had felt frustrated by their loss of control of the commercial bus market, they had been able to regain significant influence through the tendering of non-commercial services, negotiation, and the brokering and administration of common ticketing systems. A major contribution of local authorities in respect of bus services was the promotion of traffic management activities such as park-and-ride schemes and bus lanes.

5.60. Dr Glaister noted that, under the London Regional Transport Act 1984, London Regional Transport had a general duty to co-ordinate passenger transport activities. One of the reasons why bus deregulation had not been introduced in London was a perceived conflict with this duty.

Competition between modes

5.61. For long-distance, intercity travel, intermodal competition was recognized as being important in securing efficiency and passenger choice. Dr Glaister said that the Rail Regulator believed the coach market could provide an important incentive to rail operators where there was no prospect of on-rail competition. There was also a degree of intermodal competition in London, where the rail network was more extensive than in any other city. In general, however, in large urban areas the two modes were complementary rather than competitive: rail offered larger, trunk services, while buses distributed passengers locally, including to and from railway stations. In these circumstances competition within, rather than between, modes provided the important disciplines for efficiency and passenger choice.

Conclusion

5.62. Integration and co-ordination had different interpretations but in urban areas some real public benefits arose from local authority intervention in the outcome of open competition. The larger PTAs had been very active in this and had struck a balance involving rail and bus franchises for non-remunerative services, as well as introducing measures such as integrated common ticketing and physical works to ease interchange. Intramodal competition remained an important market discipline, whilst intermodal competition existed but was seen as less important in local conurbations. It was for local authorities and others to judge whether the balance between competition and integration was reasonable, but Dr Glaister doubted that it would be seriously distorted by a degree of common ownership of bus and rail.