

7 Views of National Express Group

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Introduction

7.1. In this chapter we summarize the evidence put to us by NEG in its written submissions and at a hearing.

Jurisdiction

7.2. We invited NEG to comment on our view that, for the purpose of determining its share of supply, we should include in our definition of the market bus services as well as other forms of passenger transport services involving journeys of more than 50 km carried out wholly within Scotland. NEG accepted that it was appropriate to include bus services in the definition. It commented that the distinction between bus and coach services envisaged in the terms of reference for the inquiry was an artificial one from a commercial perspective. The majority of Citylink's services were registered as local bus services because they were used to transport passengers relatively short distances as well as distances exceeding 50 km. Bus operators also competed directly with Citylink over various sections of its routes. The inter-urban services provided by the larger bus operators were precisely the type of service provided by Citylink, and bus and coach services in Scotland were generally very similar products, with coaches offering a 'turn-up-and-go' service. NEG estimated that around 85 per cent of Citylink tickets were sold on board the coaches or at bus/coach stations, a percentage similar to that for bus companies.

7.3. We also invited NEG's view on whether revenue from those services operated by ScotRail for SPTE which involved journeys of more than 50 km should be attributed to NEG in calculating its share of total supply. NEG did not think it would be appropriate for us to include that revenue in our assessment since it went to SPTE. Although ScotRail operated rail services and collected revenue on behalf of SPTE, it had no commercial interest in the services, in that it received the same contractual fee irrespective of how many passengers were carried.

7.4. NEG said that it had no reason to question our view that the share of supply test was passed whether or not SPTE services involving journeys of more than 50 km were included in the definition of the market. It agreed that, in view of the difficulties involved in breaking down revenue by length of passenger journey, our calculation should be based on total revenues from routes wholly within Scotland whose total length exceeded 50 km.

NEG's strategy and management

7.5. From its origins in the bus and coach industry and initial focus on scheduled express coach services NEG had grown through a series of acquisitions into a group with wide interests in passenger transport activities. It had acquired businesses from the public sector in the belief that they could be operated more effectively under commercial management. It had increased their profitability not only by reducing costs but also by a combination of investments in capital projects, better motivation of local management, a clearer focus on customer needs and improvements in the efficiency and quality of services.

7.6. NEG saw itself as a long-term player in the public transport industry. It believed that in order to stay in the business it needed to provide a product that was capable of competing with the car. Its aim, in all its businesses, was to run efficient services which offered value for money and high quality and which attracted high volumes of passengers.

7.7. NEG told us that its management was highly decentralized in keeping with the local nature of its businesses. It had a small headquarters organization concerned with strategic development and financial control. There were four operating divisions each headed by its own chief executive who was responsible for the conduct of the companies within the division (including pricing policies), subject to overall group policy (such as that fares should represent good value for money). Each company within a division also had its own management team. The businesses were managed independently of NEG headquarters on a day-to-day basis although they worked to agreed financial targets. As far as investment decisions were concerned, local managers could spend up to a certain limit subject to there being provision in the budget, but decisions on major capital spending were taken by the full main board of NEG after detailed scrutiny of proposals from local management teams.

7.8. Each of NEG's five TOCs had its own board of directors. The size and number of TOCs it had acquired had led NEG to create a trains division, so that it could get the full benefit of economies of purchasing and could apply best practice techniques. The trains division would also take an overview on compliance assurance procedures.

7.9. NEG told us that it operated its rail businesses on a wholly separate and independent basis from its coach business. ScotRail and Citylink were run as completely separate businesses, each of which had its own growth and financial targets to achieve. It was no part of their business to consider ways in which they might

cross-subsidize other businesses within the group. Each company's management determined its own marketing strategies, service levels and fares without reference to the other company. The only exception would be where co-ordination was necessary in order to offer complementary services and an integrated transport system. In such circumstances other operators would not be excluded from any co-ordinated arrangements.

Overlaps¹ between ScotRail and NEG's other services

7.10. NEG emphasized that there was little or no overlap between much of ScotRail's network in Scotland and Citylink's coach routes. It told us that some 57 per cent of Citylink's 169 main coach stops in Scotland were more than seven miles away from the nearest railway station. In particular there was very little overlap in relation to routes in and around Glasgow where ScotRail acted as a contractor to provide services on behalf of SPTE. Those services accounted for approximately two-fifths of the passenger miles and three-quarters of the passenger journeys carried by ScotRail.

7.11. In NEG's view an overlap between routes did not necessarily constitute a competitive overlap. It suggested that the overlaps between ScotRail's and Citylink's services were most appropriately considered on a route-by-route basis and could be broken down into SPTE-controlled services; ScotRail's London-Scotland sleeper services; rural services; non-PTE urban services; and inter-urban services.

SPTE-controlled services

7.12. There was only one incidence of overlap between ScotRail and Citylink within the SPTE area. ScotRail provided an electric rail service between Gourock and Glasgow whilst Citylink provided a coach service on that route. ScotRail's service was operated on behalf of SPTE, which continued to determine fares and service levels on this route and all other routes where ScotRail supplied services on its behalf. SPTE retained all revenue from these services and there was no revenue-sharing arrangement in the event of traffic growth. Subsidy payments were not affected by traffic volumes. ScotRail's services for SPTE were also subject to SQUIRE, which provided for a system of financial penalties and incentives depending on ScotRail's performance in delivering a wide range of quality measures. NEG submitted that the merger would have no effect on these services in view of SPTE's control over them.

London-Scotland sleeper services

7.13. ScotRail offered overnight rail services, which included sleeping accommodation, between London and Scotland. NEL provided coach services between London and Scotland.

Rural services

7.14. NEG identified four main overlapping point-to-point journeys on rural routes in Scotland: Glasgow-Oban; Glasgow-Fort William; Inverness-Thurso; and Inverness-Kyle of Lochalsh. It told us that on Inverness-Kyle ScotRail's services did not serve any of the intermediate points served by Citylink. ScotRail's cheapest fare on all four journeys was the Saver fare, which was subject to price caps under the provisions of the franchising agreement. NEG argued that even if Citylink's pricing policies had been conditioned by those substantially more expensive rail fares, the constraint would not be relaxed as a consequence of the merger.

¹Defined in the footnote to paragraph 2.19.

Non-PTE urban services

7.15. ScotRail operated a network of urban services which were centred on Edinburgh and provided local radial links into Edinburgh for its travel-to-work area. Citylink had no comparable network of services and the only material overlap arose in relation to services between Dunfermline and Edinburgh. There were two other coach operators on this route.

Inter-urban services

7.16. NEG identified 12 main overlapping point-to-point journeys on Scottish inter-urban routes, over most of which it faced competition from other TOCs and/or coach operators.

Competition between the various modes of transport

7.17. In NEG's view there were substantial differences between transport markets in Scotland and those in England and Wales and the extent of competition between the different modes of transport varied between the different categories of services described above.

Competition between coach, rail and air between London and Scotland

7.18. NEG considered that its coach services provided only marginal competition for ScotRail's sleeper services in view of the substantial differences in the attributes and costs of the respective modes of transport. ScotRail's sleeper return fares were all at least 80 per cent more expensive than NEL's coach fares. ScotRail's sleeper services and the NEL coach services on the London-Scotland routes represented only a small proportion of the relevant public transport market, which included services run by other TOCs and air services. Air transport provided substantial competition to ScotRail in relation to business travellers, who were sensitive to differences in journey time, and also leisure travellers, given the substantial growth in discounted air fares offered by companies such as British Midland, EasyJet and RyanAir. NEG considered that the NEL coach services between London and Scotland competed more directly with the discounted rail fares offered by Virgin and GNER on their non-sleeper services than the more expensive and limited-capacity sleeper services offered by ScotRail. It submitted, therefore, that the overlap between ScotRail's sleeper services and the NEL coach services was *de minimis*.

Competition from the car in Scotland

7.19. NEG believed that public transport faced greater competition from car travel in Scotland than in the rest of Great Britain. Access to a car was particularly important in rural areas where public transport services were limited, and car travel was substantially more convenient. Generally within Scotland trunk and inter-urban roads were less congested than comparable roads in England and this contributed to the attractiveness of travel by car. The development of park-and-ride links also facilitated car travel on longer journeys, as well as encouraging car owners to use local transport services.

Competition between coach and rail services on the inter-urban routes

7.20. The differences between ScotRail's and Citylink's services in terms of relative frequency, journey times and fares varied considerably across the overlapping routes. However, many of the faster coach journeys were similar in duration to the slower rail journeys (with Glasgow-Aberdeen and Aberdeen-Perth being the notable exceptions) and coaches were more frequent than rail on 7 of the 12 overlapping journeys. 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 they 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, and on eight of the journeys the cheapest return rail fare was at least 40 per cent more expensive. The conditions attached to the use of APEX rail fares were considerably more restrictive than those attached to the economy return coach fare.

Competition from airlines on the inter-urban routes

7.21. ScotRail faced competition from various airlines on journeys between Glasgow and Aberdeen, Edinburgh and Aberdeen, Glasgow and Inverness and Edinburgh and Inverness. The journey time by air was considerably shorter than by rail, making these services particularly attractive for business passengers. NEG said that airlines on these routes did not directly compete for leisure travellers as they offered few low-priced promotional tickets. However, in the light of the recent introduction by EasyJet and RyanAir of highly competitive air fares on the London-Scotland routes (which competed directly with leisure rail fares), it seemed quite possible that such direct competition might develop in the future. In particular, increases in leisure rail fares might be expected to encourage competitive promotions on these air routes within Scotland.

Competition between coach and rail services on the rural routes

7.22. On the four overlapping rural journeys listed in paragraph 7.14 rail services were typically slower (with the exception of Glasgow-Oban where rail and coach journey times were comparable) and offered no advantages in terms of frequency, but ScotRail's cheapest return fares were considerably more expensive than Citylink's comparable fares. The smallest price differential in percentage terms arose on the Glasgow-Oban route and rail fares were still approximately a third higher on this route. On all the other routes rail fares were 57 to 79 per cent higher than the comparable coach fare. In these rural areas both train and coach services were dominated by the tourist industry and the seasonal influence it created but NEG maintained that nevertheless they generally operated in different markets.

7.23. NEG submitted that it was not tenable to argue that ScotRail's services imposed an important competitive constraint on Citylink's rural services which might be lost as a consequence of the merger. NEG's research indicated that coach passengers were prepared to pay a premium for faster journeys. In such circumstances, it was difficult to see how expensive rail services had a significant constraining influence on equally fast *and* cheaper coach services.

Overview

7.24. NEG considered that at most there was only an element of competition between ScotRail's and Citylink's services on the various Scottish inter-urban and rural routes. More importantly, it did not consider that the loss of this element of competition would raise appreciable competition concerns in the light of the existence of the more significant competitive constraints discussed below.

Direct competition from other TOCs and coach/bus operators on the overlapping urban, inter-urban and rural routes

7.25. NEG provided information about the services of other TOCs and coach/bus operators on the main overlapping routes between Scottish towns and cities-see Chapter 4. It commented that GNER would be able to reduce its journey time between Glasgow and Edinburgh to 40 minutes (compared with 50 to 62 minutes for ScotRail) if a proposal, publicly described by GNER as very exciting, to electrify a secondary line through Shotts were to be implemented. In this regard, NEG asked us to note that the moderation of competition regime implemented by the Rail Regulator did not protect a TOC from another TOC's actions where it already operated services on part of the same route or had the ability to do so under its current track access agreement. Other TOCs could, and did, alter their services and/or pursue competitive pricing strategies on all such routes. For example, GNER had introduced dedicated Daypex day return fares on 30 inter-urban Scottish journeys (including Aberdeen-Edinburgh, Aberdeen-Dundee and Inverness-Edinburgh) which were cheaper than the interavailable rail fare and APEX tickets.

7.26. A number of the overlapping journeys where GNER and Virgin already operated were among ScotRail's largest flows in passenger revenue terms. NEG commented that it was to be expected that competitive services would be most viable on these journeys. For example, GNER and Virgin already ran services between Glasgow and Edinburgh (ScotRail's largest point-to-point journey by a significant margin in terms of passenger revenue) and between Aberdeen and Edinburgh (ScotRail's third largest point-to-point journey), and GNER already operated between Edinburgh and Inverness (ScotRail's 20th largest point-to-point journey).

7.27. We asked NEG for its views on comments made to us about GNER's alleged failure to fill unused capacity on its Glasgow-Edinburgh service by winning passengers from ScotRail. NEG believed that GNER would increasingly be considering ways to fill its spare capacity. It was not the lead operator on the Glasgow-Edinburgh flow and therefore had greater flexibility to introduce dedicated or promotional fares. For example, at the end of 1996, in order to encourage telesales of dedicated £19 single or £38 return tickets for travel between Edinburgh or Glasgow and London, GNER had offered customers free vouchers which were valid for travel on its trains between Edinburgh and Glasgow. The promotion had been at no cost to GNER, since it had filled otherwise unused capacity. NEG said that GNER's use of dedicated fares had implications for ScotRail since all revenue from such fares would accrue to GNER, whereas in the case of interavailable tickets some passengers travelling from the west of Scotland to England would use ScotRail's connecting services to interchange at Edinburgh and the fares revenue would therefore be shared between GNER and ScotRail.

7.28. NEG told us that Citylink faced coach/bus competition over much of the overlapping inter-urban routes. In particular, Stagecoach had substantially expanded its express coach services in recent years. These Stagecoach Express services had been launched in Scotland in 1993 and in June 1995 had been expanded to compete directly with Citylink's services between Glasgow and Dundee and Edinburgh and Dundee. These services operated via Fife rather than Perth (the Edinburgh-Dundee service was also via Dunfermline). In May 1997 Stagecoach had started services between Glasgow and Cumbernauld which competed directly with Citylink's services. NEG provided information indicating that Stagecoach's services were highly competitive with Citylink's in terms of frequencies, journey times and fares. It told us that Citylink had been compelled to cut its fares in response to the competition from Stagecoach.

7.29. In June 1997 FifeFirst (part of FirstBus) had introduced services between Edinburgh and Dunfermline which competed directly with Citylink's and Stagecoach Express's services on that route. Between Glasgow and Stirling Citylink faced competition from Midland Bluebird (a subsidiary of FirstBus) whose services were slightly slower but more frequent than Citylink's. Given FirstBus's resources and the fact that it already provided frequent services along this route, NEG considered that there would be substantial scope for Midland Bluebird to introduce fast direct services between Glasgow and Stirling should profitable opportunities arise. The MMC had recommended that FirstBus be required to divest the enlarged Midland Bluebird,¹ but in NEG's view the most likely purchaser would be another large bus company based elsewhere in the UK and with very substantial resources to develop the business.

7.30. We invited NEG to comment on a view put to us that there were important differences between the economics of the inter-urban bus services provided by other operators, including Stagecoach, and the

¹*FirstBus plc and S B Holdings Limited: a report on the merger situation*, The Stationery Office, Cm 3531, January 1997.

economics of Citylink's coach services. It had been suggested to us that the inter-urban bus services were essentially extensions to local bus networks, catering for a range of journey purposes, which therefore faced a much less seasonal pattern of demand than Citylink services where (other than on the Glasgow-Edinburgh route) most passengers were likely to be travelling for leisure purposes. It had also been suggested that the capital cost of vehicles used for inter-urban bus services was much lower than the cost of the standard Citylink-specified coach, because journeys on inter-urban services tended to be no longer than about 90 minutes whereas many journeys on Citylink services took much longer and required a higher standard of comfort and facilities. (The Glasgow-Edinburgh route was again an exception.)

7.31. NEG did not accept that there was a clear distinction between inter-urban bus services and Citylink's services, a high proportion of which were registered as local bus services and participated in local authority concessionary fare schemes. Even on Citylink's longer inter-urban routes many passengers travelled only short distances. Nor did NEG accept that all rival operators to Citylink were providing services that were essentially extensions to local bus services. It told us that Stagecoach Express services between Glasgow/Edinburgh and Dundee (which competed directly with Citylink's services) took considerably longer than 90 minutes (Glasgow-Dundee took 145 minutes and Edinburgh-Dundee 112 to 160 minutes). Accordingly, NEG believed that the customer base of Citylink was not substantially different from that of other bus/coach operators in Scotland.

7.32. In NEG's view, the type of vehicle required for long-distance travel was not a material distinction between bus and coach services. It commented that 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 services used higher-quality coaches than those used by Citylink and its vehicles were typically newer than Citylink's, reflecting the recent substantial expansion of Stagecoach's network. NEG stated that in the MML report the MMC had not disputed that the capital costs of NEL's coaches (generally of a higher quality than Citylink's coaches) were low and exit costs were modest.

7.33. NEG said that Citylink also faced competition from other coach/bus operators on parts of the overlapping rural routes, namely the routes from Inverness to Thurso, Dornoch and John O'Groats.

Threat of new entry by other TOCs and coach/bus operators

Potential rail competition

7.34. Under the moderation of competition arrangements ScotRail had been granted protection on the following six routes where its services overlapped with those of Citylink and no other TOC had any existing service: Aberdeen-Glasgow; Dundee-Glasgow; Stirling-Glasgow; Inverness-Glasgow; Perth-Glasgow; and Oban-Glasgow. NEG believed that the second stage of moderation, which would run from April 1999 to March 2002, would give limited protection on a number of existing routes whilst permitting entry by other TOCs on a number of flows that were currently protected. Before April 1999 those TOCs that currently ran services within the ScotRail franchise area were able, by extending existing services or running additional services when their rolling stock had spare capacity, to operate in competition to ScotRail, particularly on the major Glasgow-Edinburgh and Edinburgh-Aberdeen routes and on local routes round Edinburgh and Aberdeen. NEG commented that track access rights could be secured from Railtrack at low rates.

Potential coach competition

7.35. NEG said 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 that other operators could compete without needing an extensive network of ticketing and sales agents to sell their tickets and provide timetable information.

7.36. Commenting on the view of the STUC that entry costs could be high in the coach business, NEG said that it would be easy for a potential competitor to establish a service by contracting-in operators in the same way as NEG. There was no need to buy vehicles in order to establish a presence in the market.

7.37. NEG said that there was no evidence that the major bus companies regarded the hypothetical threat of aggressive or even predatory responses to new entry as a barrier. Only one of the ten large bus/coach companies surveyed by the MMC in the context of the NEG/MML inquiry considered that this factor was an

important impediment to new entry. The resources of Stagecoach and FirstBus were so substantial that it was highly implausible that predation could ever be a viable strategy against them. NEG added that the OFT had not acted on any of the various unsubstantiated allegations made by competitors during the NEG/Saltire inquiry, nor had it brought to NEG's attention any further complaints about Citylink's competitive conduct.

7.38. Several major bus companies were under contract to provide coach services for NEG. There was little evidence of reluctance on their part to set up in competition with NEG because of fears that this would lead to the loss of their operating contracts. Only one of the ten large coach companies surveyed by the MMC in the NEG/MML inquiry considered that the possible loss of its contract with NEL was an important impediment to competition. Equally important, this consideration had deterred neither Stagecoach nor FirstBus (both of which had been NEL's contractors) from expanding their services in competition with Citylink. Their position as contractors had not been adversely affected as a result. Smaller bus/coach operators seemed more likely to extend their local networks in a limited radius rather than to attempt to cover an entire major route such as Glasgow-Aberdeen. NEG did not believe they would be reluctant to exploit gaps in the market or mistakes by incumbent operators.

7.39. NEG did not prohibit its contractors from competing against Citylink. There was evidence that they were prepared to compete if they saw a good commercial opportunity. Rapsons operated a service between Ullapool and Inverness in competition with Citylink and was also a Citylink contractor on that route as well as being its principal contractor on routes between Inverness and Glasgow, Edinburgh and Wick/Thurso. Midland Bluebird operated several routes for Citylink on its inter-urban services whilst competing with Citylink on the Glasgow-Stirling route.

7.40. Both Stagecoach and FirstBus had operating bases (including depots and maintenance facilities) on most parts of the overlapping routes. NEG believed that they could expand their services at very little cost should profitable opportunities arise. It told us that Stagecoach had operating bases in almost all of the main towns on the routes between Inverness and Edinburgh/Glasgow and in Aberdeen and provided services between Aberdeen and Inverness. It was, therefore, well placed to extend its Glasgow-Dundee and Edinburgh-Dundee services through to Aberdeen. FirstBus had operating bases in Edinburgh, Dunfermline and Glasgow.

7.41. Access to stands at bus/coach stations was not a barrier to entry and expansion. The vast majority of the stations on the overlapping routes were not owned or managed by any part of NEG, the only exception being Perth bus/coach station which was leased by Strathtay but managed by Citylink. NEG told us that its competitors had access to stands at all these stations (including Perth), and even stands which had been allocated to Citylink were freely available to competitors throughout the day as they were typically used for only a short period each hour. A competitor wanting to enter the market at very low cost could avoid the charges for using a bus station by making coach stops at the roadside.

7.42. NEG considered that actual and potential competition from other bus/coach operators imposed a strong competitive constraint upon Citylink's services on the overlapping routes. Such competition was not merely a theoretical possibility, as was evidenced by the large-scale expansion in June 1995 of Stagecoach's network to compete directly with Citylink, the recent expansion of FirstBus's services on the Edinburgh-Dunfermline route, and Stagecoach's new services between Glasgow and Cumbernauld. NEG believed that the scale of new entry in the various Scottish markets would have been considerably greater if Citylink had not enhanced its services since 1993 to the benefit of customers, for example by increasing the frequency of services between Glasgow and Edinburgh and on other inter-urban routes and developing a comprehensive network of routes in rural areas.

Effects of the merger

7.43. NEG maintained that the merger did not bring together two directly competing transport operators whose networks directly overlapped to serve a common market. Instead, it involved two largely complementary transport networks which served a variety of different markets with different characteristics. NEG found it difficult, in the light of the modest overlap between ScotRail and Citylink, to see how it could exploit any perceived competitive advantage it might have as a result of the merger. Its analysis of the overlaps in services (see paragraphs 7.10 to 7.24) had led it to conclude that they were insignificant for the most part.

7.44. We asked NEG to comment on suggestions made to us that it would be in its interests to seek to increase patronage of Citylink's coach services at the expense of ScotRail's services by, for example,

withdrawing some rail services or failing to market them vigorously. NEG said that it was required by the franchise agreement to make a considerable investment in ScotRail and thus had a strong incentive to achieve a return on its outlay. Cost reductions alone would be insufficient to earn an adequate return; a significant growth in passenger revenue over the period of the franchise would be needed for success. It would not, therefore, be in NEG's interests to try to effect a switch of passengers from rail to coach. In any event, the withdrawal of rail services was largely precluded by the PSR. In general, on routes where its services overlapped with Citylink services ScotRail was operating at the level of the PSR and so could not make cuts without breaching the franchise agreement. (The only significant exception was the Glasgow-Edinburgh route where ScotRail was operating a half-hourly service in the evening although the PSR required only an hourly service.) Even if it were possible for ScotRail to run fewer trains, there would be no great cost savings since it would be left with surplus rolling stock and would still be committed to the large fixed element of Railtrack's track access charges. NEG commented that there was no evidence that passengers would transfer to coach services if rail services were withdrawn. In its view, it was more likely that they would travel with other TOCs where this was an option or by car.

7.45. It had also been suggested to us that NEG might pursue the converse policy of withdrawing Citylink services, or raising coach fares, with the aim of increasing patronage on ScotRail's services. NEG commented that such moves would be counter-productive. There was no guarantee that potential passengers would take the train if coach services were withdrawn. They would be just as likely to go by car or reduce the frequency with which they travelled. Furthermore, the strategy would damage Citylink's profitability, particularly in the longer term, since once the customer base had been lost there could be no certainty that it would return if services were reinstated. NEG said that the demand for coach travel was price elastic. Citylink's revenue was therefore likely to fall if fares were increased.

7.46. NEG also pointed out that the ScotRail franchise agreement required it to provide twice the current frequency and 50 per cent additional capacity on the Glasgow-Edinburgh route from May 2000. Rail capacity would then move from being about three times Citylink's capacity to about four and a half times. In that context the coach business was immaterial to the growth of traffic required. ScotRail would need to increase the volume of passengers by attracting those who would normally travel by car and by encouraging both existing passengers and new ones to undertake additional journeys.

7.47. There would be a significant threat of entry by competitors if NEG reduced the frequency or quality of coach services or raised prices. Commenting on a specific concern that had been raised with us about the future of Citylink's services between Edinburgh and Glasgow, NEG said that any reduction in service would give an operator such as FirstBus (which had existing depots in the vicinity) the opportunity to start a competing service. Since the route was only 46 miles long, coaches could be turned round quickly and a high frequency achieved with a relatively small investment. It would also be possible for Stagecoach to enter the route, using its existing depot in Glasgow and either acquiring a similar depot in Edinburgh, which NEG believed would not be difficult, or running services from its existing base in Fife.

Sleeper services

7.48. We raised with NEG the suggestion put to us that it would be unlikely to be vigorous in providing and marketing seating accommodation on its sleeper services between London and Scotland, because of the possibly detrimental effect on NEL's business. NEG pointed out that it was committed by the ScotRail franchise agreement to introduce reclining seats on the sleeper services, as part of a requirement to improve the whole quality of service. The sleeper services were substantially more expensive than the overnight coach service and its passengers, a mix of business and leisure travellers, fell mainly into socio-economic groups A and B whereas coach passengers were generally leisure travellers from socio-economic groups C, D and E. In NEG's view, therefore, there was only marginal competition between the sleeper services and NEL's overnight coach services.

7.49. NEG also refuted any suggestion that it would not actively market overnight coach services to London following its acquisition of ScotRail. There had been major marketing initiatives in the summer of 1997, which had seen strong growth on NEL's London-Scotland services, and further initiatives were planned for 1998.

Rail and coach services in rural areas

7.50. We discussed with NEG the possibility that on overlapping rural routes, particularly those where coach travel was as fast as or faster than rail travel, it would be in its commercial interests to reduce rail fares in a bid to increase rail patronage by attracting passengers away from Citylink services. NEG said that this would not be a practicable proposition. It would not make commercial sense to discount rail fares in the summer months when tourist business was at its peak, but discounting fares in winter was unlikely to attract sufficient numbers of additional passengers to make a significant difference. ScotRail had tried to stimulate winter business in the past, with only limited success.

7.51. We suggested that, given the seasonality of coach travel on the rural services, NEG might decide to run them only in the summer, leaving ScotRail to pick up the passengers in winter. NEG said that Citylink had always had the option of tightening supply in winter. It had not done so because of its long-term commitment to building the business. It commented that seasonal withdrawal of services would be a risky and unwise strategy for the reasons set out in paragraph 7.45. In addition, the low frequency of coach services on the rural routes meant that any reduction would represent a large cutback (for example, a reduction from four to three services a day would be a 25 per cent cut) and would make it impossible to provide a comprehensive service at the times when passengers wished to travel.

7.52. NEG told us that in the short term Citylink's costs would not be reduced by withdrawing coach services, because payments to contractors were fixed for a season. Contractors normally apportioned their fixed costs over the number of miles they expected to operate on behalf of Citylink. A cut in services in winter would lead to fixed costs being reapportioned over the summer mileage and an overall increase in hire rates in terms of pence per mile. In the longer term, reductions in the number of vehicles would reduce revenue, and hence profitability, by a disproportionately greater extent because demand would fall as frequency of service declined (timings of services and the intervals between them would be less convenient for many customers). Furthermore, the withdrawal of services on certain point-to-point coach journeys would adversely affect longer routes of which those journeys represented a small part. NEG considered, therefore, that it was important to maintain the Citylink network throughout the year.

7.53. NEG also pointed out that Citylink's services in rural areas did not cater solely for tourists; they served many local flows along the routes and were registered as bus services. Notice would have to be given to the appropriate Traffic Commissioner if a service was to be withdrawn and the local authority might be obliged to take action to fill the gap. Withdrawal would provide substantial opportunities for competitors to enter the market or extend their existing operations in the rural areas. In particular, Stagecoach had a base at Inverness and had recently expanded its services northwards to Dornoch whilst FirstBus had a minority shareholding in Oban and District Buses Ltd, a provider of local services in the Oban area and to Fort William, which would give it access to a depot in that area, thus facilitating entry.

7.54. We invited NEG to comment on a suggestion made to us that the merger had already been shown to be against the public interest because the frequency of Citylink's summer service between Pitlochry and Glasgow had been cut. NEG said that the summer timetable had been planned without reference to the merger and there had been no co-ordination with ScotRail, which was run entirely separately from Citylink.

7.55. We put to NEG an alternative suggestion that it might cut back or discontinue rural train services during the winter, in the expectation that passengers would switch to Citylink's coach services. NEG said that this would not be a viable strategy, for the reasons set out in paragraph 7.44.

Inter-urban rail and coach services

7.56. NEG said that on the 12 main inter-urban routes where both Citylink and ScotRail provided services, the rail and coach businesses faced substantial competitive and regulatory constraints which had not been relaxed as a consequence of the merger and which would determine its competitive conduct. It considered that the constraints were substantially greater than those which applied on the reference routes in the NEG/MML inquiry and were sufficient to prevent it from increasing fares excessively or otherwise abusing its position.

Competition from the car

7.57. NEG told us that the car was the main competitor in Scotland, even on routes where public transport was very frequent, and suggested that car ownership in most of Scotland was higher than elsewhere in the UK. The success of NEG's acquisition of ScotRail was predicated on car users being persuaded to switch to rail travel. The required growth in traffic could not be achieved by withdrawing coach services from overlapping routes and attempting to divert passengers to the rail network because, NEG believed, the vast majority of those coach passengers would be diverted to existing competing TOCs and coach/bus operators or would travel by car. Furthermore, reductions in the frequency and standard of Citylink services would create major entry and expansion opportunities for rival bus/coach operators.

Competition from other operators

7.58. NEG drew our attention to the considerable direct competition from other operators on the overlapping inter-urban routes (see Chapter 4 and paragraphs 7.25 to 7.29). It commented that no such direct competition had existed in relation to any of the reference services in the NEG/MML inquiry.

7.59. The only rail fares which competed to some extent with coach fares were discounted leisure rail fares, most notably APEX fares which had to be booked in advance and which required travelling times to be specified. NEG said that notwithstanding ScotRail's position as lead operator on substantially all flows within Scotland, there were no constraints on the introduction of dedicated discounted leisure fares by other TOCs with an existing presence in Scotland. NEG believed GNER to be an aggressive competitor keen to encourage customers to use its services. To that end, it had launched its Daypex fares (see paragraph 7.25) and had offered free tickets on the Edinburgh-Glasgow route as part of a promotion relating to its Edinburgh/Glasgow-London services (see paragraph 7.27). NEG expected price competition between TOCs to intensify given the financial pressure on them to maximize their contribution to their large fixed costs.

Potential competition

7.60. NEG drew our attention to its analysis of potential rail competition (see paragraph 7.34) and potential competition from air services (see paragraph 7.21).

7.61. With regard to scheduled coach services, NEG pointed out that the MMC had identified certain barriers to entry in England and Wales in the NEG/MML report. NEG argued that these barriers did not apply to the major bus and coach groups in Scotland, for a number of reasons. First, the majority of Citylink's passengers travelled relatively short distances and did not buy their tickets in advance. Operators providing services in those circumstances did not need a large network of agents to sell tickets and provide timetable information. This was different from the situation in England and Wales, where NEL operated an extensive network. Secondly, the main inter-urban routes in Scotland were not part of longer routes and in general passengers did not tend to use them as a means of linking into a wider network. Thirdly, recent entry and expansion, as described in paragraphs 7.28 and 7.29, demonstrated that NEG contractors were prepared to set up in competition with Citylink. Fourthly, one of the barriers to entry identified by the MMC in the NEG/MML inquiry was the risk that NEL would match a new entrant's fares. NEG suggested that the MMC were concerned that this response to competition would be highly aggressive or predatory. In NEG's view, however, the substantial resources of Stagecoach and other major bus groups already operating in Scotland made it unlikely that predation could be a viable strategy against such operators.

Regulatory constraints

7.62. NEG said that on 2 of the 12 main overlapping inter-urban journeys (Glasgow-Perth and Aberdeen-Perth) the cheapest rail fares were Saver fares which were subject to price caps under the provisions of the franchise agreement.

Staffing levels

7.63. We put to NEG some concerns expressed to us that ScotRail's staffing levels would be further reduced with a view to increasing profitability and that this could have detrimental effects on the level, quality and safety of services. NEG said that it could not reduce staffing levels to the extent that its ability to deliver the commitments in the ScotRail franchise agreement was threatened. Service levels were rigorously monitored by the Franchise Director through the performance incentive regime. Whilst staff numbers had been reduced in recent years this had had no impact on safety. Any further reductions would have to meet ScotRail's safety case, which set out how safety matters would be handled. The granting to a TOC of a train operator's licence by the Rail Regulator was conditional on acceptance of the safety case by Railtrack.

NEG's conclusion

7.64. In the light of its evidence on the effects of the merger, NEG submitted that its acquisition of ScotRail would not have significant adverse effects on competition or, therefore, adverse effects on fares or on the frequency, reliability or quality of public transport services.

Public interest benefits

7.65. NEG believed that the merger offered substantial public interest benefits, which would be directly to the advantage of consumers, taxpayers and the environment (by encouraging car users to travel by rail).

Franchise commitments

7.66. Operation of the ScotRail franchise by NEG would save some £55 million a year over the life of the franchise in comparison with BRB's claim for the year 1996/97. Notwithstanding the significantly lower subsidy, NEG was committed by the terms of the franchise agreement to supply to the public a significantly higher quality of service than that formerly provided by BRB: service frequencies would be improved, funds would be committed to improving standards at stations and there would be investment in new rolling stock. NEG was also committed to achieving a higher level of punctuality and reliability.

7.67. In particular, NEG was planning to introduce elements of a co-ordinated timetable between coach and rail to encourage the use of public transport, particularly on routes which were currently poorly-served; joint multi-modal ticketing, involving other operators; and interchangeability of tickets between coach and rail on the Aviemore-Inverness route. All these initiatives were intended to promote greater use of public transport.

NEG's record as an owner of TOCs

7.68. NEG said that it was committed to providing rail services which promoted excellence and efficiency for the benefit of passengers and taxpayers. It drew attention to its record as an owner of TOCs in its first year of operating the MML and Gatwick Express franchises. MML had seen a growth of 9 per cent in passenger volumes and significant improvements in punctuality and reliability. Many new products and services had been introduced, an extensive programme of train refurbishment had been started, plans to acquire new rolling stock had been announced, security at railway stations had improved and a feasibility study had been commissioned for a new station to serve EMIA and the M1. The volume of customer complaints received had fallen by 5 per cent since NEG acquired the franchise. The already high levels of punctuality and reliability on the Gatwick Express service had been improved over the year. NEG told us that it had developed the service through a range of measures that included increasing the frequency of services in the evenings and introducing services through the night. It had announced plans to order new rolling stock to replace the existing fleet of trains by 1999. Customer complaints had fallen significantly during the year and customer satisfaction surveys had confirmed an improvement in passengers' perception of the service.

7.69. NEG said that it intended to apply the same approach to the operation of ScotRail. It planned, for example, to improve the frequency of service on the Edinburgh-Glasgow and Fife Circle routes, to refurbish rolling stock, to invest £1 million in improving station security and accessibility, to introduce an evening flat

fare and extend APEX fares to new flows and, in partnership with local authorities, to develop park-and-ride facilities in Edinburgh and Glasgow.

NEG's approach to an integrated transport system

7.70. NEG told us that the breadth of its interests in transport services gave it a unique perspective on intermodal transport, rendering it well placed to assist the Government to implement an integrated transport policy. NEG's view was that an integrated system of public transport was one which sought to build on the complementary strengths of each type of transport to offer real alternatives to the car for as wide a range of journeys as possible. NEG's rail franchise plans contained a wide range of initiatives designed to encourage substantial growth in rail passenger numbers. In practical terms this meant improving the co-ordination between different modes of travel; NEG believed this could be done through a variety of means, including bus feeder services linking to rail services, park-and-ride stations, bookable taxis, improved rail links to airports, urban light rail services, co-ordinated ticketing and information and the development of new stations and services in partnership with local authorities and PTEs.

7.71. In Scotland NEG's ownership of Citylink and the ScotRail franchise offered it the opportunity to co-ordinate train and coach timetables in the Highlands-to fill in the significant gaps in ScotRail's network-as well as to offer joint and through-ticketing between coach and rail. A range of initiatives was planned. NEG was committed by the ScotRail franchise plan to introduce a bus feeder service between Inverness station and the Ullapool ferry terminal for a trial period of two years and a bus feeder service to be specified by SPTE, also for two years. It was also committed to feasibility studies into park-and-ride opportunities in the SPTE and Edinburgh areas and to joint promotion, with SPTE, of existing facilities. In addition, there was to be a joint feasibility study with SPTE into a rail link to Glasgow Airport.

7.72. A suggestion had been made to us that NEG's commitment to rail links to Glasgow and Edinburgh airports was in doubt because Citylink had a coach service to Glasgow Airport and NEL ran services from Scotland to the major airports in England. NEG said that under the terms of the ScotRail franchise agreement it was fully committed to the Glasgow Airport feasibility study and had already discussed proposals with SPTE. It was also working with Edinburgh City Council on a proposal for a rapid transit busway to Edinburgh Airport which would involve an interchange with ScotRail and other TOCs' services. NEG confirmed that it was strongly committed to the two airports and the opportunities they offered it.

7.73. Innovations and trials were in hand in the area of co-ordinated ticketing and information. NEG was planning to co-ordinate timetables and offer through-ticketing between coach and rail, with coach services operating between Inverness, Fort William and Oban and between Kyle of Lochalsh and Mallaig to fill key gaps in ScotRail's network. Joint ticketing would be offered between Aviemore and Inverness, where both coach and rail services were relatively infrequent, allowing outward and return journeys by different modes without the passenger paying the penalty of higher, single fares. ScotRail was also designing a type of rover ticket, valid on coach and rail throughout Scotland, with very clear attractions for tourists and the tourism industry. NEG commented that the purpose of through-ticketing was to make travel easier for passengers. NEG would consider allowing through-ticketing with other operators, subject to reaching suitable commercial arrangements. Although there were currently no competitors on several of the rural routes for which arrangements were being planned, a proposal for through-ticketing in the Dundee area could easily be extended to include other local operators such as Strathtay.

7.74. NEG said that the activities and proposals described above not only demonstrated its commitment to achieve integrated public transport systems. They also displayed a determination, and a need for commercial purposes, to address the real competition in the transport sector: that between public transport and the private car.

Views on remedies

7.75. We invited NEG to comment on divestment of all or part of the business of ScotRail as a remedy should the MMC conclude that the merger might be expected to operate against the public interest. NEG said that such a remedy would be completely disproportionate given the modest overlaps between ScotRail and Citylink and the minor effect of the merger on competition. It thought that a recommendation for partial divestment would be unwelcome to the Franchising Director and that there could be considerable difficulties with the technical and regulatory aspects that would be involved in changing the franchise agreement.

7.76. We also asked for NEG's views on the divestment of Citylink as a potential remedy. NEG thought that this too would be totally disproportionate. Although Citylink had a relatively small turnover and was not a highly profitable business, it was nevertheless important to NEG in terms of achieving its aims for public transport in Scotland and also in providing links to NEL in England and Wales. NEG thought that disposal of Citylink might not be an entirely straightforward matter. Citylink was a product that had some goodwill associated with it, but NEG did not own any of the coach routes. This meant that another company could start running services over the same routes without needing to buy the business from NEG. If a potential buyer for Citylink could be found, NEG would want to be satisfied that the current integration with the rest of the coach network would be maintained, so that Citylink passengers could continue to switch easily to NEL for journeys to English destinations. It would not be in NEG's commercial interests to lose those customers, nor would it be in passengers' interests to lose the connections between services.

7.77. NEG commented that [

Details omitted. See note on page iv.

] it had made some modest commitments to do with integration of public transport on the assumption that it would own both ScotRail and Citylink. If it were to be required to make disposals then the commitments under the franchise agreement would have to be undone.

7.78. We asked for NEG's views on potential behavioural undertakings which might cover fares, availability of different categories of tickets, frequency and quality of services and agreement about the monitoring of performance against the undertakings. NEG said that [*Details omitted.*
See note on page iv.] it would be prepared to accept undertakings on those lines, provided that they were limited to specific overlapping routes where competition concerns had been identified.

7.79. We suggested a further undertaking to require NEG to ensure that all its intermodal or inter-operator ticketing arrangements were open to any other operator. NEG said that this would be acceptable and was in line with what it already intended to do in the Highlands and around Dundee.

G ODGERS (*Chairman*)

D J JENKINS

D P B KINGSMILL

J F PICKERING

P A BOYS (*Secretary*)

30 September 1997