

Customer benefits

Introduction

1. The Act provides that, when deciding on remedies, we may consider the effects of any action on relevant customer benefits related to the creation of the merger situation. We should disregard any benefits that do not meet the criteria for being a 'relevant customer benefit'. This appendix outlines some possible customer benefits mainly based on information in the franchise documents and FirstGroup's bid. Although FirstGroup considered that its bid offered significant benefits to passengers, the SRA and the Scottish Executive, it did not initially claim that any of these constituted relevant customer benefits as defined in the Act.

Relevant customer benefits

2. Under the Act, relevant customer benefits must result from the merger and be unlikely to have come about without the merger or a similar lessening of competition. They are limited to benefits to 'relevant customers' in the form of:
 - lower prices; or
 - higher quality or greater choice of goods or services in any market in the UK; or
 - greater innovation in relation to such goods or services.

They must also be expected to arise within a reasonable period. Relevant customers are customers at any point in the chain of supply. They are not limited to final consumers and include future customers.

Effect on remedies

3. If we think that relevant customer benefits would result from the merger, we need to consider whether we should modify the remedies that would otherwise be put in place. Ideally we may seek a remedy that eliminates or reduces the detrimental effects of the substantial lessening of competition (SLC) while preserving all or most of the customer benefits. A number of factors need to be considered, including:
 - the size and nature of the expected benefit;
 - how long it will last, taking into account any likely erosion of the immediate benefit to customers as a result of the SLC; and
 - any differing impacts of the merger on different customers.

Possible customer benefits in this case

4. When we consider any claimed merger benefits, we first need to consider whether any of them qualify as customer benefits and then to consider whether they are 'relevant'. In principle, benefits to passengers could arise in at least three areas: (a) new services or increased frequencies; (b) improved quality of service; and (c) improved integration with other forms of transport. In practice, the draft franchise

agreement heavily constrains the franchisee's ability to change its train services from those set out in the agreement and sets demanding quality of service standards. The benefits offered by the three bidders in these areas are therefore likely to be very similar but not identical. There is thus more scope to offer discretionary improvements in transport integration; voluntary improvements in other areas are likely to be marginal.

5. In addition, we need to consider whether any of the claimed merger benefits, which are benefits to customers other than passengers, should be taken into account. In particular we may need to consider possible benefits to the SRA, the SPTE and the Scottish Executive (which we considered to be customers in defining the markets). These might take the form of cost savings, improved value for money or the delivery of public policy objectives.
6. In considering whether the customer benefits are relevant, we need to decide whether similar benefits are likely to be offered by the other bidders or may be obtainable in other ways.

FirstGroup's overall views on merger benefits

7. FirstGroup commented in detail on potential passenger benefits both in its tender and in evidence submitted to us. As it had been chosen as the preferred bidder for the Scottish rail franchise, FirstGroup concluded that its bid must have been more advantageous for passengers, the SRA, SPTE and the Scottish Executive than the bids submitted by Arriva and National Express. It considered that its bid did not merely adopt the minimum required standards: it had made substantial commitments that materially exceeded this minimum level. Although the rail services and service levels in the bids would be very similar, given the minimum standard set by the service level commitment, FirstGroup said it had differentiated its bid by offering improved transport integration and higher quality services. These were intended to increase passenger growth, thus generating the additional revenue needed to finance the improvements offered in FirstGroup's bid.
8. As well as investing in a higher quality of service than the minimum requirement, FirstGroup considered that it could bring benefits to the franchise through its management relationships in Scotland. As the largest bus operator in Scotland, FirstGroup claimed that it would be well placed to roll out integrated travel improvements quickly and would have a unique platform from which to promote integrated ticketing across Scotland. FirstGroup said that it could pursue new opportunities for integration that would bring considerable benefits to passengers. Although FirstGroup had no unique capabilities, it claimed that it had been more imaginative than others in defining and offering promises to the SRA about integration schemes. It would work to establish a Transport Integration Group (TIG) that was open to other transport operators and headed by a transport integration manager.
9. [REDACTED]
10. FirstGroup commented that it was unable to comment on any financial benefits to the SRA, SPTE and the Scottish Executive that might result from its bid; this would depend on comparing FirstGroup's bid with that of the underbidder, which it was unable to do.

The SRA's views on merger benefits

11. The SRA pointed out that the franchise agreement required the franchisee to participate in certain integrated transport schemes. It may be required to take part in other schemes specified by the SRA or the SPTE, provided that the franchisee's involvement would have no adverse financial effect on it. In addition, the franchisee has to participate fully in the current pilot 'One-Ticket' scheme in the SESTRAN area and three (still to be specified) integrated ticketing initiatives. Taking account of these requirements, the SRA told us that it did not consider that any integrated transport schemes depended on the merger.

The SPTE's views on merger benefits

12. The SPTE felt that it was desirable to have at least three bidders. It considered that all the benefits it anticipated from the merger could be achieved by other means provided for in the Transport (Scotland) Act 2001:
 - improved bus/rail coordination could be achieved through quality partnerships or quality contracts;
 - integrated information provision could be achieved through public information arrangements; and
 - integrated ticketing and through ticketing could be achieved by ticketing schemes.

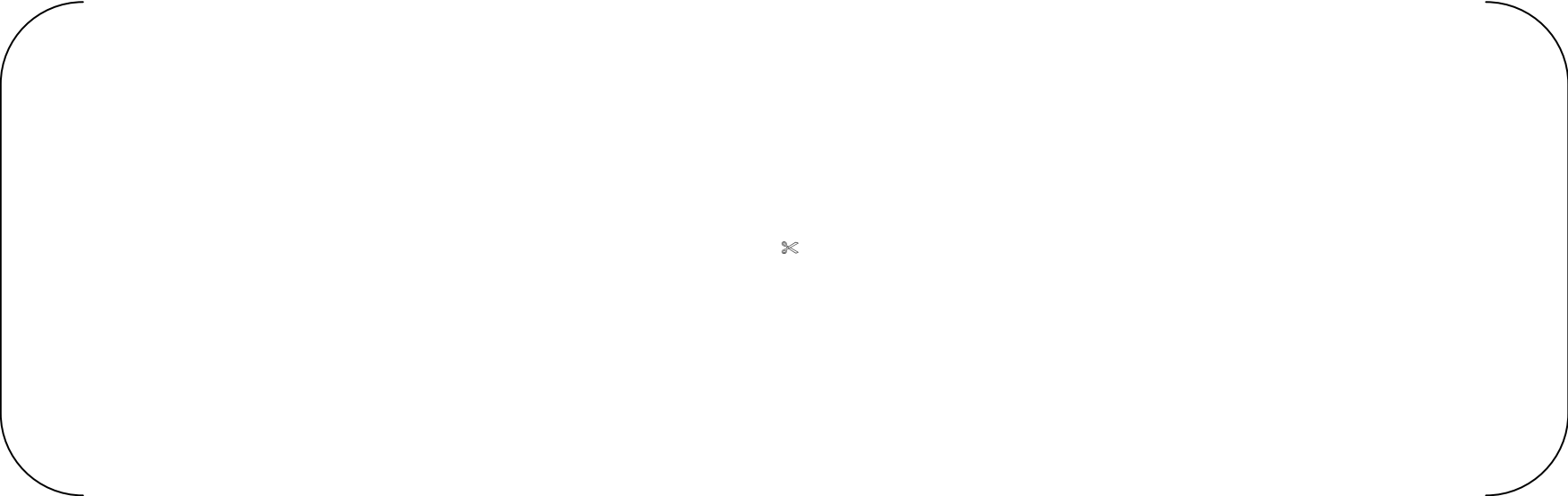
The Scottish Executive's views on merger benefits

13. The Scottish Executive told us that it was in the public interest to maintain downward competitive pressure on the cost of the franchise by keeping all the bidders in the franchise process. It could not identify specific examples where the separation of ownership at the moment had been an obstacle to transport integration; any benefits from joint ownership were likely to be at an informal level. The Scottish Executive considered that ScotRail had a reasonable record of trying to achieve integration with other operators, particularly through ticketing.

Detailed merger benefits claimed by FirstGroup

14. FirstGroup made numerous claims in its bid about service improvements that it could achieve. [✂]

TABLE 1 [✂]

Category	Objectives	Qualitative impacts	Quantitative measure	Present value
ENVIRONMENT				
SAFETY				
ECONOMY				
ACCESSIBILITY				
INTEGRATION				

15. [X]

New services or increased frequencies

16. In its bid, FirstGroup promised to establish a number of RailLink bus services, which would act as feeder services into the rail network. [X]¹

17. [X]

Improved quality of service

18. [X]

19. [X]

20. [X]

21. The passenger charter, CCTV and revenue protection policies are ITT requirements. New rolling stock is being financed by the Scottish Executive. Any improvements that FirstGroup's bid offered, over and above the minimum standards, may either be similar to those offered by other bidders or counterbalanced by equally important benefits offered by them.

Improved integration with other forms of transport

22. The ITT required bidders to submit plans for inter-modal travel and integrated transport. The franchisee would have to cooperate with any schemes required by the SRA for integrating rail with other forms of transport. If participating would have no adverse financial effect on the franchisee, the SRA can designate a scheme as a 'ScotRail franchise agreement integrated transport scheme'. SPTE can ask the SRA to designate any integrated transport scheme that has no adverse effect on the franchisee. The franchisee has to participate in designated schemes and take such steps as the SRA may reasonably require.

Interchanges

23. In its bid, FirstGroup promised to cooperate with local authorities and bus companies to optimize the location of bus stops in relation to station access points.

Integrated ticketing

24. The ITT requires the franchisee to participate fully in any integrated ticketing initiatives which Scottish Ministers consider to benefit the public. This will include the current pilot 'One-Ticket' scheme in the SESTRAN area and up to three pilot integrated ticketing initiatives by 2006. Start up costs for the three pilot schemes will be met by the Scottish Executive. The franchisee will be expected to meet the ongoing administrative costs of participating in the pilot schemes and any future integrated ticketing initiatives.

¹[X]

25. In its bid, FirstGroup promised to support the PlusBus scheme² and to promote and assist in the delivery of a Scotland-wide smartcard scheme enabling passengers to use bus and/or rail transport with only one card. This would be open to other operators and could also be extended to other transport modes such as ferries, airports and the proposed Edinburgh tram network. The smartcard scheme would facilitate selling tickets online and by telephone. FirstGroup also promised to seek to develop integrated ticketing schemes in the Aberdeen area and the Dumfries and Galloway, Perth, Tayside and Highland regions.

Passenger information

26. The ITT requires the franchisee to become a member of Traveline Scotland and any other multi-modal public transport information system designated by the SRA. In the longer term, the franchisee will be expected to participate in Transport Direct, which aims to provide the traveller with all the information needed before and during a journey anywhere in the UK.
27. In its bid, FirstGroup said that it would participate in Transport Direct and Traveline Scotland and improve multi-modal transport information (including signage) at stations. Its staff would be trained and equipped to give better information to passengers.

Airports

28. In its bid, FirstGroup promised to improve integration between rail and airports through coordinated marketing, integrated links, integrated ticketing and providing airport information at rail terminals. It said it would seek through ticketing arrangements with bus operators linking rail services to airports. These would build upon existing products such as ZoneCard and one-ticket wherever possible. FirstGroup would promote rail-airport interchange points with information on onward travel by bus, taxi and other modes.

Other

29. FirstGroup promised to work with tourism bodies to develop and promote rail-linked tourism. It also said it would improve cycle parking facilities at stations and commission a roadside cycle breakdown organization to provide assistance for passengers with cycles.

Possible benefits to the SRA, SPTE and the Scottish Executive

30. As we consider that public bodies are 'relevant customers', we also need to assess any benefits to them claimed by FirstGroup. The immediate potential benefit to public bodies is the likelihood, given that it has been chosen as the preferred bidder, that FirstGroup's bid represents better value for money than the other bids. As we have not seen the other bids, the value of this benefit is difficult to assess.
31. Other possible benefits to the public bodies include the achievement of their policy objectives. In practice these are likely to centre on benefits to passengers that are

²PlusBus is an add-on fare that offers passengers buying rail tickets unlimited bus travel on participating bus services near their destination railway station.

very similar to those considered already. They might, however, include other wider benefits considered in SDG's assessment, such as environmental benefits from reduced road congestion, that would not normally be thought to be customer benefits.

Would the benefits occur without the merger?

32. FirstGroup told us that it was unlikely that any of its proposed improvements would be realized at the same speed, or to the same extent, if it did not win the franchise. The best integrated transport schemes were most likely to come from substantial providers of both bus and rail transport. Of the ScotRail bidders, FirstGroup thought that only it and National Express could make that claim. As National Express bus services in Scotland were limited to Dundee, FirstGroup considered that no other bidder had significant bus services across large parts of Scotland. FirstGroup believed that being a multi-modal transport operator would enable it to achieve much more than other bidders.
33. None of the public bodies considered that FirstGroup's bid would lead to benefits that could not be obtained in other ways.

The Central Trains case

34. The Commission considered similar issues when National Express was bidding for the Central Trains franchise. It believed that some transport integration benefits would result from the Central Trains franchise being in the same ownership as the major bus operator in the West Midlands. The following extracts are taken from the discussion of the benefits of the merger in conclusions chapter of the Central Trains report:

2.100. As regards transport integration, several third parties-including Centro³ and five local authorities, both within and outside the West Midlands – considered that the merger offered valuable opportunities as a result of NEG's involvement in different transport modes. Some referred to NEG's good record in pursuing such opportunities. Integration between modes does not depend on common ownership but in principle it should be easier for operators in common ownership to reach agreement on matters such as intermodal ticketing and we agree that NEG is well placed to take the lead in developing and implementing integrated systems in the West Midlands. We would have been concerned if NEG were enabled by the merger to pursue that goal in ways which excluded other bus operators, so weakening competition. It is likely that developments in Government policy following the White Paper will be designed to foster cooperation between independent operators. To that extent the integration benefits of the merger may be diminished.

2.105. We believe that some benefits will result from the merger in the form of initiatives to promote transport integration in the West Midlands (see paragraph 2.100).

35. There are, however, three important differences between that inquiry and the current inquiry. First the Commission was at that time applying a public interest test under

³The West Midlands PTE.

the Fair Trading Act, which required that merger benefits should be considered at an earlier stage in the inquiry; second, the requirements in that round of TOC franchise agreements were much less tightly specified than they are today; and third, additional powers (including those in the Transport (Scotland) Act 2001) are now available to public bodies.

36. FirstGroup considered that these differences did not necessarily mean that the Commission should now take a different view from that taken in the Central Trains report. The ITT still left bidders with discretion on the details of their bids and FirstGroup felt that it had used this discretion to offer service quality and integration benefits over and above the minimum requirements. As FirstGroup did not consider that these benefits could necessarily be obtained in other ways, it thought that they would satisfy the requirements for 'customer benefits'.