

Decision to review the undertakings affecting FirstGroup's bus business across Southern and Central Scotland

Introduction and summary

1. The Competition and Markets Authority (CMA) has decided to conduct a review of the undertakings given in 2002 by FirstGroup plc (FirstGroup), and amended in 2008, in relation to the completed acquisition by FirstGroup of SB Holdings Limited (SBH) ('the 'undertakings').¹ The undertakings apply to services operated by FirstGroup across the Scotland East and Glasgow areas. These are significant bus markets in which FirstGroup operates approximately 255 tendered and commercial routes.
2. The CMA has a statutory duty under section 88(4) of the Fair Trading Act 1973 (as applied by paragraph 16(3) of Schedule 24 to the Enterprise Act 2002) to keep the undertakings under review. In doing so the CMA shall from time to time consider whether, by reason of any change of circumstances, the undertakings are no longer appropriate and FirstGroup can be released from them or the undertakings need to be varied or to be superseded by new undertakings.
3. The CMA has set out in its published guidance, *Remedies: Guidance on the CMA's approach to the variation and termination of merger, monopoly and market undertakings and orders* (CMA11), that in deciding whether to conduct a review of an undertaking, the CMA will consider its published prioritisation principles and whether there is a realistic prospect of finding a change of circumstances.²
4. The CMA's decision to conduct a review of the undertakings was made pursuant to the guidance in CMA11 and follows receipt of an application from FirstGroup setting out evidence of a change of circumstance and consideration of responses to a public invitation to comment on that application.³ This provided grounds for the CMA to consider that there is a realistic prospect of finding a change of circumstances and that conducting a

¹ These undertakings can be viewed at: [FirstBus plc - notice of undertakings \(CC\)](#).

² See: [CMA11](#), paragraph 3.10.

³ See: [FirstGroup plc – request to release undertakings](#).

review would be in accordance with its prioritisation principles. On the basis of this evidence, the CMA also decided that the review should be conducted without delay.

Background

5. An original version of the undertakings were given, in 2002, to the then Secretary of State for Trade and Industry under section 88 of the Fair Trading Act 1973. This followed a review by the Monopolies and Mergers Commission (MMC) of the 1996 acquisition of SB Holdings Limited, a Scottish bus operator. In 2006 the Office of Fair Trading (OFT) recommended that FirstGroup should be released from the undertakings. The Competition Commission (CC) decided not to follow the OFT's recommendation but instead varied the undertakings by revising the fare cap and rebasing the mileage floor.
6. The undertakings are now as follows:
 - (a) Price cap (increase based on H-CPT index)⁴ in Scotland East and Glasgow.
 - (b) Mileage floor (no less than 75% of 2002 levels) in Scotland East.
 - (c) Other anti-predatory behavioural restrictions:
 - (i) A requirement for bus services to be evenly spaced between those of competitors' service.
 - (ii) An obligation not to increase commercial competition against tendered services in areas where FirstGroup has been unsuccessful in tendered bids.

Consultation on whether to review

7. On 31st August 2015 FirstGroup submitted an application to the CMA to release it from the undertakings⁵ by reason of change of circumstances. The CMA consulted on whether it should conduct a review of the undertakings. As set out in CMA11, we sought views on whether the CMA should carry out a

⁴ The H-CPT index was created following the CC's review in 2008. It is calculated from the components of a cost index published by the Confederation of Passenger Transport UK (the CPT index). The H-CPT is calculated using the cost increases from the index used in Great Britain for all cost categories except fuel costs, and using the fuel increases from the CPT (Scotland) index.

⁵ See: [FirstGroup plc – request to release undertakings](#).

review in the light of the issues raised by FirstGroup and CMA's [prioritisation principles](#). The invitation to comment asked three questions:

- whether there has been a change in circumstance in this market, which obliges the CMA to consider a review of the undertakings;
- whether we should prioritise this case for review; and
- whether this review should be carried out now.

8. The consultation commenced on the 7 September and closed on the 25 September 2015. We received 12 responses.⁶
 - In response to the first question, 11 out of 12 parties responded. Of these, all 11 parties considered there was at least an indication that there had been a change of circumstances. The party that did not respond did not consider that the undertakings should be reviewed.
 - In response to the second question, ten out of 12 parties responded. Seven parties considered that the CMA should prioritise undertaking a review, two parties stated that it was a matter for the CMA to decide, and one party told us that the CMA's prioritisation principles did not support the prioritisation of this case.
 - In response to the third question, five parties considered that the CMA should conduct a review now and one party stated that the review should not take place.
9. Some parties also commented on the rationale for a review. The points they made are outlined in the next section of this document together with FirstGroup's main arguments.

Submissions received regarding possible change of circumstance

FirstGroup's submissions in relation to increasing competition

10. FirstGroup submitted that the original rationale for the undertakings was incompatible with the CMA's latest analysis of the market, stating that the CMA found that potential competition and entry are not significant constraints on incumbent operators.⁷ FirstGroup noted that the original concern of the

⁶ Lothian, Transport Focus, Strathclyde Partnership for Transport, Stirling and Clackmannanshire councils, East Lothian Council, Transport Scotland, South East Scotland Transport Partnership, Age Scotland, Scottish Borders Council, Stagecoach, McGill's, and West Lothian Council.

⁷ FirstGroup referred to the CC's final report (2011), [Local bus services market investigation](#), p11 & 12, paragraph 11.54.

MMC was the loss of potential competition between the Glasgow and Scotland East businesses. In relation to this, FirstGroup said:

- (a) Recent reviews of bus mergers had focused on effects on head-to-head competition as opposed to potential competition. The CC's views following the market investigation, based on the then current market data and more extensive and sophisticated analysis than was available to the MMC at the time of the SBH merger, were inconsistent with the competitive assessment that led to the SBH undertakings being imposed. As such, the original rationale for the SBH undertakings no longer appeared supported on the more up-to-date methodology. FirstGroup therefore considered that if, hypothetically, the companies had remained separate, but a merger were to be considered by the CMA today, in light of recent precedent, a substantial lessening of competition finding would be highly unlikely.
- (b) The undertakings had initially been put in place to address concerns about a possible loss of potential competition; however, since 2008 FirstGroup had faced increasing actual competition in the areas affected by the undertakings from a number of operators, including major players such as Lothian Buses (Lothian), Stagecoach UK Bus and McGill's Buses (McGill's).
- (c) In addition to increased bus competition, a number of new rail and tram lines had been, or shortly would be, introduced across the area covered by the undertakings. These new options for passengers to travel by public transport had had, or were highly likely to have, a significant impact on the level of competition faced by FirstGroup.

Response to our consultation in relation to increasing competition

11. In response to our consultation:⁸

- (a) All of the bus companies that responded identified that there had been a change of circumstance in the relevant market and that it would be appropriate for the CMA to consider a review of the undertakings.⁹
- (b) Two responses identified there had been an increase in competition from smaller operators. This had been reflected in FirstGroup losing out to

⁸ Some respondents commented on more than one area and so their comments may be reflected in more than one of the summarised bullets below.

⁹ Lothian, Stagecoach and McGill's.

smaller operators for subsidised services tendered by the relevant councils.

- (c) Three respondents told us that FirstGroup had actually experienced decreased competition in some areas as a number of smaller operators had ceased trading or had withdrawn from the local bus service market.
- (d) Four respondents told us that increased rail services operating into Edinburgh from the West and East as well as the newly opened Borders Railway, had greatly increased travel options for those making journeys to and from Edinburgh.
- (e) One respondent told us that FirstGroup should not be released from the undertakings. It considered that there was not an increase in competition in the FirstGroup Glasgow area and that it was not in the public interest to undertake a review of the undertakings.

FirstGroup's submissions in relation to changes in costs and demand

12. FirstGroup also submitted that reduction in demand and increases in costs that disproportionately affected the local bus travel market in Scotland meant that it had been unable to fully recover its costs. In relation to this, FirstGroup said that:
- (a) Demand for local bus travel in Scotland had declined significantly since 2008, with a steady decline in both passenger journeys and vehicle miles. At the same time the number of passengers travelling on concessionary fares had increased.
 - (b) It faced increasing costs that would not be accounted for under the price control mechanism. The H-CPT pricing mechanism, as a generally UK-wide index, had not accurately reflected the costs of operating bus services within Scotland, such as increasing labour costs and cost and investments associated with increases in vehicle quality, as well as to technical and environmental specifications. In addition, operators within urban areas, such as FirstGroup, had also faced disproportionately higher fuel costs as a result of significant changes to the way BSOG was allocated in Scotland, which had not been reflected in the price control mechanism.
 - (c) It must invest substantially to ensure it complied with the Public Service Vehicle Accessibility Regulation 2000. FirstGroup said that the costs of financing investment were not reflected in the H-CPT index and as such it would not be able to recover these costs through price increases. It also said that departure charges for the use of the new bus station in

Galashiels would be five times those associated with the old facility. These costs were specific to one area in Scotland and would not be fully reflected in the H-CPT.

Response to our consultation in relation to changing costs and demand

13. One bus company said that changes made to the BSOG in April 2012 was one of the most significant changes to funding faced by the bus industry in Scotland in recent times. They were able to deal with this through service revisions and higher fares. The respondent also told us that it had witnessed a reduction in the BSOG budget in England and it expected a similar tightening of budgets in Scotland in the near future.
14. One respondent told us that it would be very difficult for FirstGroup to re-invest and comply with public service accessibility regulations by 2017 given the current market conditions.
15. One respondent said that, although the total number of full fare paying passenger journeys across the FirstGroup networks had decreased, there had been an overall rise in concessionary fare passenger journeys. The respondent was concerned that bus operators may opt to reduce less profitable routes to the disadvantage of particularly isolated communities or segments of the population.

Decision

16. The responses to the consultation and our own assessment of the evidence presented to us, provide grounds for the CMA to consider there is a realistic prospect of finding a change of circumstances relating both to changes in the levels of competition within the Scotland East and Glasgow areas and to the costs and demand elements of the undertakings.¹⁰
17. We have considered the parties' request for review in light of the CMA's [prioritisation principles](#). Given that the CMA conducted an extensive local bus services market investigation in 2011¹¹ and is now undertaking a statutory review of the public transport ticketing schemes block exemption,¹² bus markets are an area of strategic focus for the CMA. With regard to the impact and strategic significance, the nature of the remedies (ie largely measures to

¹⁰ See CMA11, paragraph 3.10, which identifies a relevant factor in whether the CMA prioritises opening a review is whether the CMA considers there is a 'realistic prospect of finding a change of circumstances'. This judgement is relevant to the prioritisation decision; the decision on whether there has in fact been a relevant change of circumstance is for the CMA group appointed to conduct the review.

¹¹ See: [Local bus services market review](#).

¹² See: [Public transport ticketing schemes block exemption: statutory review](#).

control outcomes) makes the arguments for a timely review of the undertakings especially pertinent. The nature of the remedies also increases the risk that the undertakings may have a distortive effect on the market, which might for example deter FirstGroup from making required future investments (for example to comply with the Public Service Vehicle Accessibility Regulation 2000). The CMA concludes that these factors justify prioritising the resources for a review. The CMA has decided that such a review should be started without delay.

18. The CMA notes further that reviewing this remedy is in line with its objectives and strategy on the basis that it reflects the CMA's statutory duty, and the commitment set out in its [2015/16 annual plan](#) to 'ensure current merger and market remedies are still fit for purpose'.
19. As well as publishing this decision, the CMA will be informing relevant parties directly of this decision to commence a review.
20. The review of undertakings will be carried out by a group of CMA panel members, appointed by the CMA Panel Chair Roger Witcomb. The group will be announced shortly. The group of panel members will be advised by a case team of CMA staff.
21. Further information on the process for conducting a review of an existing remedy is outlined in CMA11¹³ and further information on the conduct of this review will be published on the [case page](#), which will be kept updated.

¹³ [CMA11](#).