

**CMA REVIEW OF THE UNDERTAKINGS AFFECTING FIRSTGROUP'S BUS BUSINESS
ACROSS SOUTHERN AND CENTRAL SCOTLAND**

RESPONSE TO ISSUES STATEMENT – FIRSTGROUP

11 DECEMBER 2015

1. Introduction

- 1.1 This document sets out FirstGroup's formal response to the Competition and Markets Authority's (*CMA*) Statement of Issues dated 25 November 2015 (the *issues statement*).
- 1.2 In the issues statement, the CMA summarises the two theories of harm identified by the Monopolies and Mergers Commission (*MMC*) in their original review of the FirstBus/SBH merger in 1996. This response considers the extent to which the MMC's theories of harm have been affected such that the undertakings can be released, focusing in particular on the four issues identified by the CMA.
- 1.3 This response will provide evidence that, as a result of significant changes in circumstances since the MMC decision in 1996 and the subsequent imposition of the undertakings in 2002, the original theories of harm addressed by the MMC no longer apply. By way of brief example:
 - (a) The MMC found that the 1996 merger would cause a loss of potential competition between FirstGroup and SBH. This is no longer of concern today. The closure of two out of three of the depots identified by the MMC as the basis on which First Bus could have entered Glasgow in competition with SBH is a change in circumstances such that the MMC's original concern is no longer warranted.
 - (b) The MMC also found that FirstGroup's "resulting dominance" in central and south-east Scotland would deter entry. This has not proven to be true. As demonstrated below, competitors such as Stagecoach, McGill's and Lothian Buses have increased their activities considerably in the relevant areas, often at the expense of FirstGroup.
- 1.4 Further, this response will show how the undertakings, rather than addressing competition concerns, are actually distorting competition in the relevant markets. For example, the constraints imposed by the undertakings are forcing FirstGroup to run unprofitable services, therefore themselves acting as a likely deterrent to potential entrants to the market. In light of such unforeseen consequences, it is appropriate that the undertakings be reconsidered and terminated.
- 1.5 The above examples are explored in greater detail below, in particular focusing on a comparison between the original findings of the MMC and the current market, demonstrating the substantial change in circumstances, and on the consideration of how the merger between FirstBus and SBH would have been assessed today.

2. The theories of harm addressed by the undertakings

- 2.1 FirstGroup understands that the CMA is reviewing the Scottish Bus Undertakings in line with its duty under the Fair Trading Act 1973¹ (*FTA*). Under the FTA, undertakings could be accepted to take “*action requisite, in the opinion of the appropriate Minister or Ministers, for the purpose of remedying or preventing the adverse effects specified in the report*” (emphasis added). Further, under the FTA, from time to time, the CMA must consider whether, by reason of any change of circumstances, an undertaking is no longer appropriate and either:
- (a) the relevant parties can be released from the undertaking; or
 - (b) the undertaking needs to be varied or to be superseded by a new undertaking².
- 2.2 The CMA’s guidance indicates that “*The precise nature of the CMA’s consideration of any change of circumstances will depend entirely on the individual circumstances affecting a particular undertaking or order. However, the change of circumstances must be such that the undertaking or order is no longer appropriate in dealing with the competition problem and/or adverse effects which it was designed to remedy, if it is to lead to either variation or termination*”³ (emphasis added). FirstGroup agrees with the assessment in the guidance that the correct test under the statute is whether the undertaking is no longer appropriate in dealing with the competition problem and/or adverse effects it was designed to remedy.
- 2.3 It is therefore necessary to assess whether, if the same merger situation were to take place today, the CMA would be likely to conclude that the merger situation may be expected to result in a substantial lessening of competition. If not, then the undertakings should be lifted. In its decision in 1996, the MMC identified little direct competition in the areas covered by FirstBus and SBH’s services. The MMC, therefore, focused its analysis on “*the key role of potential competition from large adjacent operators*.”⁴ As set out in the Statement of Issues, the undertakings were put in place to deal with two competition problems or adverse effects; specifically, the MMC found in 1996 that the merger of FirstBus and SBH would:
- (a) cause a loss of potential competition between FirstBus and SBH, and between FirstBus and other parties; and

¹ As preserved in Schedule 24 of the Enterprise Act 2002.

² Section 88(4) of the FTA provides that: “*Where... particulars of an undertaking given by any of the relevant parties have been furnished to the Director, it shall be the duty of the Director: (a) to keep under review the carrying out of that undertaking, and from time to time consider whether by reason of any change of circumstances, the undertaking is no longer appropriate and either the relevant parties (or any of them) can be released from the Undertaking or the undertaking needs to be varied or to be superseded by a new undertaking.*”

³ CMA11, Remedies: Guidance on the CMA’s approach to the variation and termination of merger, monopoly and market undertakings and orders, para 2.5.

⁴ Monopolies and Mergers Commission, *First Bus and S B holdings Limited: A report on the proposed merger situation* (23 December 1996) (*MMC decision*), para 2.60.

- (b) FirstBus’ “resulting dominance” in central and south-east Scotland would deter entry.

2.4 The MMC set those concerns out in more detail in its decision and it is useful to understand that analysis in order to assess the changes in circumstances since 1996:

- (a) *Loss of potential competition between FirstBus and SBH.* The MMC was of the view that FirstBus (then operating in the Scotland East area) was well-placed to compete in Glasgow given Midland Bluebird’s presence north and east of the city, and that it would not have been “beyond its resources” to obtain a depot in Glasgow.⁵

- (b) *Loss of potential competition between FirstBus and other parties.* The MMC identified two separate concerns:

- (i) First, that FirstBus’ position in the region “*effectively turned most of central and south-east Scotland into a ‘safe haven’; that is an area which is out of the reach of the existing depots of major players in contiguous areas*” (it is not clear that this concern is distinct from the concern articulated at (a) about a loss of competition between FirstBus and SBH, as such, this submission generally addresses these two concerns together); and

- (ii) Second that “*the ability of FirstBus to retaliate against an existing operator that seeks to expand its business in central and south-east Scotland is significantly increased by the merger: potential competitors are likely to be deterred from entering into significant competition with FirstBus by the size of its bus fleet and its access to finance, as well as by the extent of its operations in the area.*”⁶

2.5 The MMC also explored whether existing constraints on FirstBus and SBH (e.g. from smaller operators, car, or other fixed modes of transportation) were sufficient to offset the competition concerns it had identified, and concluded that they were not.

2.6 The original MMC decision was issued at a time of significant flux in Scottish bus services. Formerly public bus services in Scotland were sold to private operators between 1990 and 1993. Many bus companies were first sold to their management and employees, and then subsequently sold to third party bus operators by mid-1996. There have now been over twenty years of private provision of local bus services in Scotland and, as the market has developed, it has been considered in detail several times by the competition authorities (in the local buses market investigation reference, and in the context of various merger decisions). With the benefit of twenty years’ experience of competition between private bus operators in Scotland, any analysis of the

⁵ MMC decision, para 2.88.

⁶ MMC decision, para 2.93

market today clearly shows that the concerns identified by the MMC are no longer relevant and, therefore, that the undertakings are no longer necessary.

- 2.7 All 11 parties who responded to the CMA's consultation in September 2015 considered that there was at least an indication that there had been a change of circumstances.⁷ Lothian Buses, Stagecoach and McGill's 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.⁸
- 2.8 As set out in further detail below, there have been significant changes in circumstance since 1996 such that the undertakings are no longer appropriate in dealing with the competition problems they were designed to remedy. First, neither of the MMC's original theories of harm hold true today:
- (a) First Glasgow and First Scotland East could no longer be considered strong potential competitors to each other, even if they were operated independently. Two of the three depots that the MMC considered to be in positions that would allow FirstBus to enter Glasgow in competition with SBH have closed (with any routes run out of these depots moving to other FirstBus depots) and, as explained below, the last remaining depot that the MMC identified as a concern is too far from Glasgow to provide a realistic prospect of entry in today's conditions.
 - (b) FirstGroup's position in Scotland has not deterred potential entrants; in fact, there has been significant entry in direct competition with FirstGroup. FirstGroup's market presence has declined significantly in a number of the key areas since 1996. In particular, FirstGroup's share of registered mileage in Glasgow City has declined from 89% to 60% as a result of competition from operators such as McGill's and Stagecoach. In East Lothian, it has declined from 45% to 9%, in Midlothian from 64% to 15% and in West Lothian from 91% to 70%. At the same time, the shares of Stagecoach, McGill's, Lothian Buses⁹ (*Lothian Buses*) and other operators have increased significantly in these areas.
- 2.9 Second, the competitive constraints on FirstGroup in both Glasgow and Scotland East have increased significantly. These constraints include the expanded networks of large operators such as Stagecoach, McGill's and Lothian Buses, increased competition from a number of smaller bus operators, and increased constraints from other modes of transport such as the car, the tram and the train. Even if First Glasgow and First Scotland East were potential competitors today, a merger between the businesses would not result in a substantial lessening of competition given the significant actual and potential competitive constraints exerted by third parties on both businesses.

⁷ Competition and Markets Authority, *Decision Statement: FirstGroup Undertakings Review* (30 October 2015) (*Decision Statement*), para 8

⁸ Decision statement, para 11(a)

⁹ Including the affiliated company of Lothian Country Buses,

- 2.10 Third, the undertakings have a distortionary effect in the market: they require FirstGroup to continue to run unprofitable and inefficient routes, and risk requiring FirstGroup to price below cost. Both of these outcomes are likely to deter entry and expansion by other operators.
- 2.11 If a merger between the former FirstBus and SBH businesses were assessed on the same basis today, either the first or the second change in circumstances set out above would on its own be sufficient to change the original conclusion such that the undertakings are no longer appropriate and should be released. Further, even if the MMC’s original findings were relevant today, which they are not, the fact the undertakings are having a distortionary effect on competition in the market again leads to the conclusion that the undertakings should be released because they are no longer appropriate.
- 2.12 FirstGroup’s response below addresses each of the theories identified in the CMA’s issues statement. In some cases, there have been changes in circumstances that are not specifically reflected in the issues statement, and these additional changes in circumstances have also been discussed below.
- 3. Effect of depot closures and depot ownership changes on the level of direct competition between FirstGroup and its competitors and the effect on potential competition**

MMC Findings

“The location of depots is usually regarded as important for the threat of potential competition ... It is clear that Midland Bluebird’s depots at Larbert, Bannockburn and Balfron are all located within 20 miles of at least one SBH depot...”

Table 4.7: Distances between SBH and Midland Bluebird depots

<i>SBH depot</i>	<i>Midland Bluebird depot</i>	<i>Distance (miles)</i>
<i>Cumbernauld</i>	<i>Larbert</i>	<i>12</i>
	<i>Bannockburn</i>	<i>12</i>
	<i>Linlithgow</i>	<i>21</i>
<i>Airdrie</i>	<i>Larbert</i>	<i>18</i>
	<i>Bannockburn</i>	<i>19</i>
	<i>Linlithgow</i>	<i>27</i>
	<i>Livingston</i>	<i>21</i>
<i>Motherwell</i>	<i>Livingston</i>	<i>24</i>
	<i>Larbert</i>	<i>28</i>
<i>Parkhead</i>	<i>Balfron</i>	<i>19</i>
	<i>Larbert</i>	<i>25</i>

- 3.1 It is important to clarify what the MMC meant by a loss of potential competition. It is clear from the context and the evidence presented by the MMC that the loss of potential competition envisaged was the loss of constraint imposed by the possibility that either FirstBus or SBH would be able to launch services into the area of operation of the other firm due to the proximity of their operations. This constraint provided an incentive on the incumbent operator “*to maintain a full network of services and to hold down fares in order to avoid providing any opportunities to adjacent operators.*”¹⁰ The MMC did not identify a theory of harm relating to actual entry by either FirstBus or SBH into the area of operation of the other firm and the decision identifies no evidence of specific plans for entry on the part of either business.
- 3.2 The MMC focused on the availability of depots as a barrier to entry, assessing the location of other operators’ depots and concluding that “*the prospects for competition were poor*”¹¹. The MMC analysed whether the depots of FirstBus/SBH were sufficiently close to the depots of the other party for such constraints to apply. “*On the basis of the positioning of their depots, both SBH and FirstBus were able, should they have so decided, to launch new services from existing depots into each others’ core areas*” [emphasis added]¹².
- 3.3 The main evidential analysis carried out by the MMC looked at the distances between the depots of the two operators¹³. The MMC found that “[*it is commonly thought in the bus industry that the maximum range of bus services from its depot is 15 to 20 miles in rural areas and 5 to 10 miles in urban areas, apart from infrequent inter-urban services.*”¹⁴ The MMC found that there were several SBH and FirstBus depots within 20 miles of each other.¹⁵ In particular:
- (a) Cumbernauld (SBH) was 12 miles away from Larbert (FirstBus) and 12 miles away from Bannockburn (FirstBus);
 - (b) Airdrie (SBH) was 18 miles away from Larbert (FirstBus) and 12 miles away from Bannockburn (FirstBus);
 - (c) Balfron (FirstBus) was 19 miles away from Parkhead (SBH).

¹⁰ MMC decision, 2.60.

¹¹ MMC decision, para 2.93.

¹² MMC decision, 2.63. This is also the interpretation of “potential competition” employed by the CC in the 2010 MIR, see paragraphs 8.103 to 8.136.

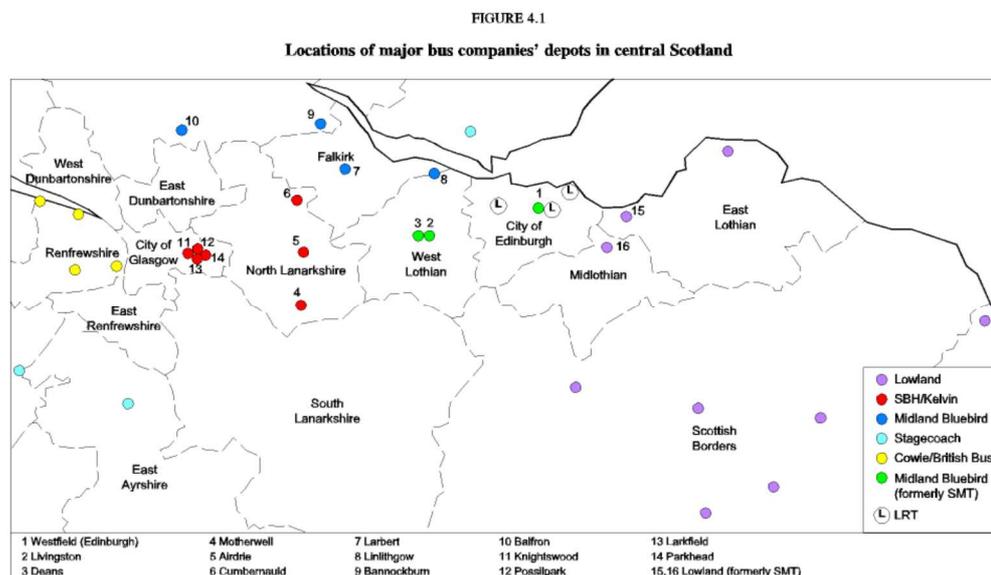
¹³ See Chapter 4 of the MMC decision.

¹⁴ MMC decision, p. para 4.51.

¹⁵ FirstGroup notes that it is unclear whether the MMC is referring to straightline or road distances between depots. Clearly, the relevant (distance based) metric for depot reach is road distance rather than the straightline distance between two points. FirstGroup notes that the road distance between any two points will always be equal to or greater than the straightline distance between any two points.

3.4 The depot locations were reported in Figure 4.1 of the report, reproduced below in **Figure 1**.

Figure 1: Depot locations 1997



Source: MMC Report, Figure 4.1

3.5 There has clearly been a material change of circumstances since 1997 in relation to the proximity of the depots of each firm (if they had remained under separate ownership). This is for the following reasons:

- (a) The Cumbernauld and Airdrie depots have both closed, meaning that the only remaining depot that would be considered to overlap is Balfron with Parkhead (which must have been only a marginal potential competition constraint at the time, being 19 miles away). The Parkhead depot is scheduled to close in January 2016,¹⁶ removing the last of the depots that the MMC considered to be in close proximity.¹⁷
- (b) The CC's more recent analysis of the reach of depots in the 2010 MIR found that the relevant criterion was a 30 minute drive time rather than a 15-20 mile radius.
- (c) Moreover, changes to BSOG and reduced road speeds resulting from greater congestion have reduced the reach of depots, as it is now more costly to operate far from a depot.

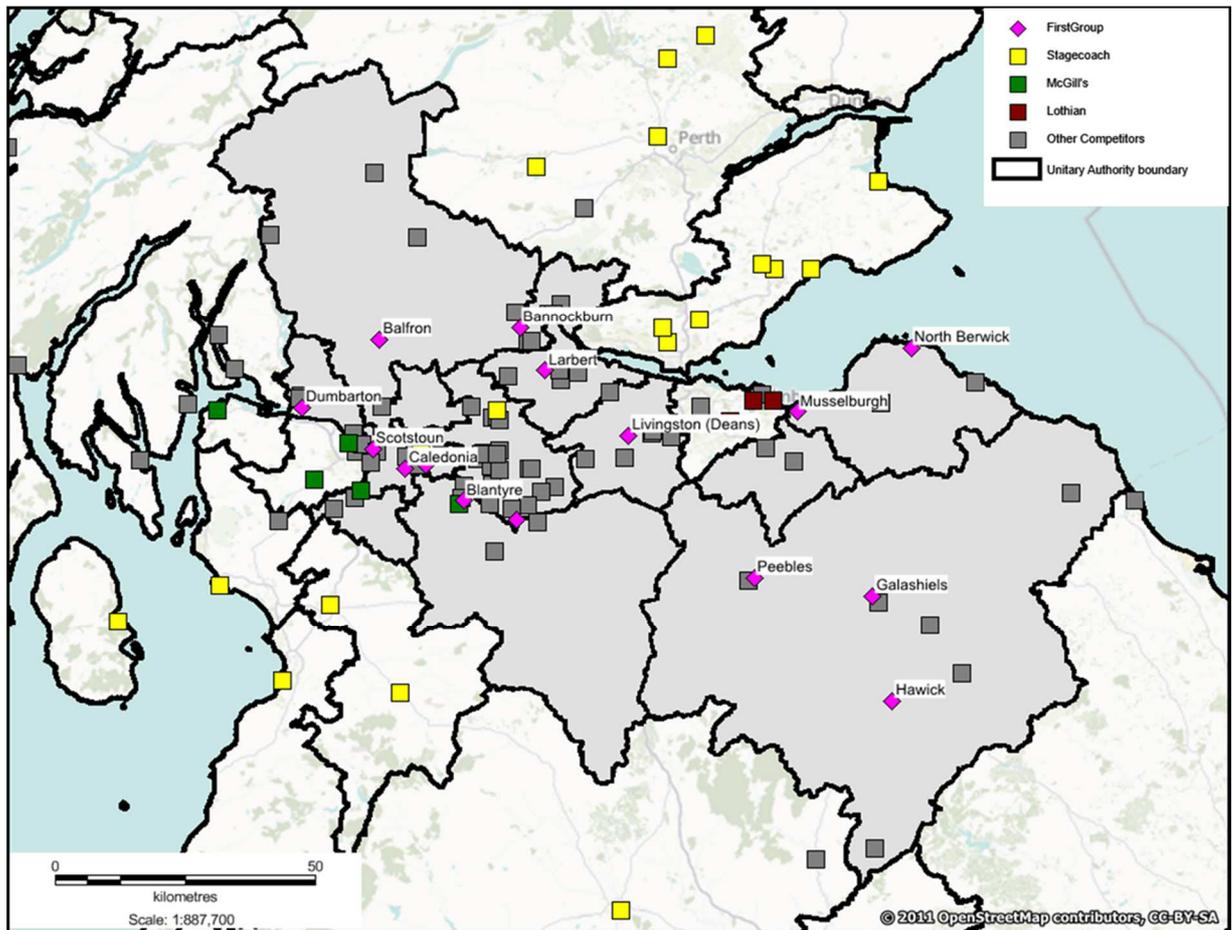
¹⁶ http://www.eveningtimes.co.uk/news/13799759.First_Glasgow_to_shut_Parkhead_depot_after_93_years/?ref=mr&lp=1

¹⁷ FirstGroup will have two depots in Glasgow as of next year (Scotstoun and Caledonia), both of which have opened after the undertakings came into force in 2002. The road distance between Balfron and these two depots is 17.5 miles (Scotstoun) and 19.6 miles (Caledonia) respectively.

Closure of Cumbernauld and Airdrie

3.6 There have been material changes of circumstances in relation to the locations of depots. At the time of the MMC Report, the most proximate SBH depots to the FirstBus depots were Cumbernauld and Airdrie. Both of these have now closed.

Figure 2: Depot locations 2015



3.7 The Airdrie depot was closed shortly after the purchase of the SBH business in 1996/1997.

3.8 Following a four-year period of sustained head to head competition between Stagecoach and FirstGroup, FirstGroup's losses at its Cumbernauld depot were so heavy the decision was taken to close it in May 2013. The key routes at the depot were unprofitable in the face of the significant competition from Stagecoach and FirstGroup concluded:

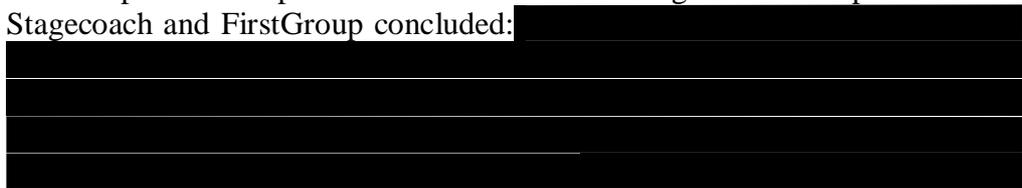
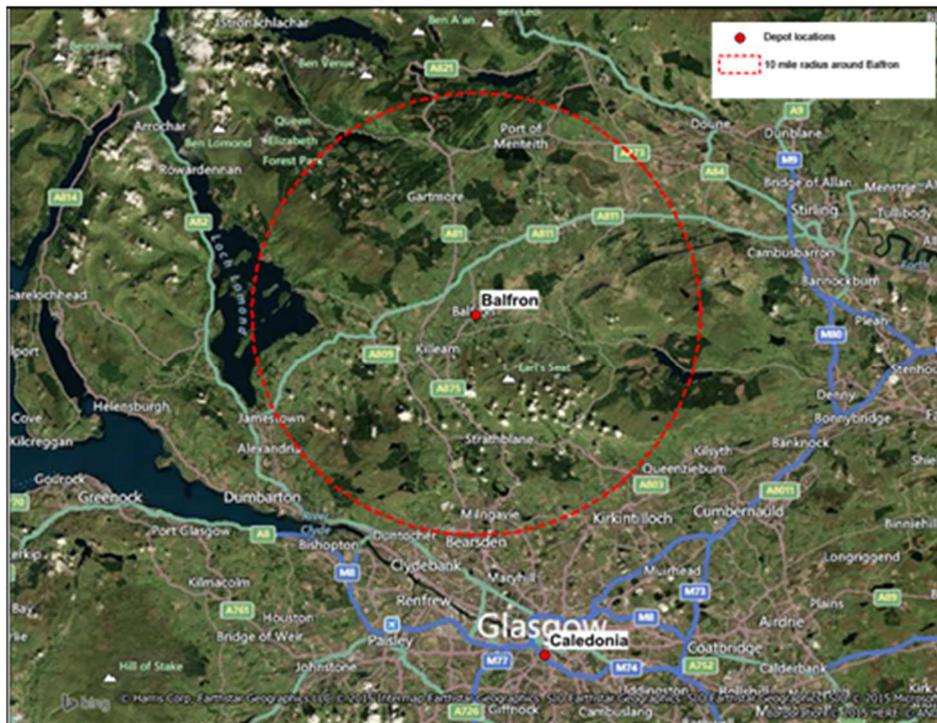


Figure 3: Balforn



3.14 For these reasons, following the closure of the Parkhead depot, the most proximate of the depots of the former FirstBus and SBH businesses will be the FirstBus Larbert and Livingston depots which are 24 and 25 miles (on the MMC’s calculations), respectively, from the Blantyre depot, which was a replacement facility for the SBH Motherwell depot. Based on the approach taken by the CC in the MIR, and given the changes to Bus Service Operators’ Grant (*BSOG*) in Scotland since the MIR, it is highly unlikely that the FirstBus depots would be well-placed to support operations on routes run out of the Blantyre depot (or vice versa).

Changes in depot reach

3.15 There have also been changes in circumstances which mean that the 30 minute drive time is no longer appropriate as it is too large. In particular, since 2012, the BSOG is no longer applied to dead mileage (i.e. miles run by buses where they are not in service). The decision to end the payment of BSOG for dead mileage has reduced the range at which services can be profitably operated from a given depot. This suggests that the relevant drive time isochrones for an analysis of the scope for potential competition between two bus operators based on the locations of their respective depots is likely to be closer to 20 minutes, rather than the 30 minutes the CC had cited in earlier decisions. This further removes any basis on which First Glasgow today could be considered a material potential competitor to Scotland East (and vice versa).

Summary

- 3.16 The undertakings were designed to remedy a loss of potential competition between FirstBus and SBH. The MMC concluded that, given the positioning of the parties' depots (in particular, SBH's Cumbernauld, Airdrie and Parkhead depots and FirstBus's Balfron depot), the parties would have been able to launch services into each other's core areas, if they had decided to do so. The Cumbernauld and Airdrie depots have both been closed for a number of years and the Parkhead depot will close in January 2016. Following the changes to BSOG and the CC's updated approach in the Market Investigation, the Balfron depot should no longer be considered a viable operating base from which to operate urban services within the city of Glasgow. Moreover, the sparsely populated nature of the area surrounding the Balfron depot means that it would not be commercially viable for any operator based in Glasgow to serve the area.
- 3.17 Even if it had at one time been possible to launch services from these depots into areas where FirstBus or SBH operated, neither the former SBH business (First Glasgow) nor the former FirstBus business (First Scotland East) is any longer in a position to do so. That change in circumstance means that the undertakings are no longer appropriate in dealing with the adverse effect they were designed to address (because that adverse effect no longer exists) and, as a result, the undertakings should be terminated.

4. **Assessment of the extent of entry and expansion by competitors to routes operated by FirstGroup since the merger and its impact on competition**

MMC findings

"The loss of potential competition... between FirstBus/SBH and other large contiguous operators"

- 4.1 The other theory of harm identified by the MMC was that the merger between FirstBus and SBH would result in a loss of potential competition between FirstBus and other larger operators. The MMC found that large operators were likely to be deterred from entering into competition with FirstBus due to its increased size and strength. As a result, the MMC expressed concern that other large operators did not pose a credible threat of entry in areas where the combined FirstBus/SBH business would operate. An increase in the threat of potential competition from these operators would itself constitute a material change in circumstance. In fact, there has been a significant increase in actual competition from large operators, in the years since the MMC decision.

There has been a significant change of circumstances with respect to competition between FirstBus/SBH and other large operators

- 4.2 In assessing a loss of potential competition between the combined FirstBus/SBH and other large contiguous operators, the MMC identified "two facets" to competition between FirstBus/SBH and other large operators:

- (a) competition from Stagecoach and Cowie with SBH’s core operations in Strathclyde²²; and
- (b) competition with FirstBus companies in the rest of central and south-east Scotland²³.

4.3 The specific concern identified by the MMC was “*the loss of potential competition... between FirstBus/SBH and other large contiguous operators.*”²⁴ The MMC “*considered whether the size and extent of First Bus’s operations in central and south-east Scotland were likely to deter competition from other major operators*”²⁵ and concluded that they would do so. There has, however, been a material change in circumstances: Stagecoach, McGill’s (formerly Cowie) and Lothian Buses have each expanded significantly in competition with FirstGroup and provide a substantial competitive constraint today, demonstrating that FirstGroup’s position in Scotland could not now be considered a deterrent to entry.

(i) *Competition from Stagecoach and Cowie in Glasgow*

MMC Findings

“It emerged from Stagecoach’s evidence that it had no intention of taking on a dominant FirstBus in Glasgow in the foreseeable future, despite its earlier interest in the area.”

4.4 The MMC anticipated that FirstGroup would not be constrained by the risk of potential entry by competitors in Glasgow. Contrary to the MMC’s expectations in 1996, Stagecoach has successfully expanded its operations in competition with FirstGroup in and around Glasgow.

4.5 Indeed, Stagecoach entered Glasgow in 1997, demonstrating that it was not deterred by FirstBus’s acquisition of SBH or FirstBus’s strong position in other areas of Scotland. FirstGroup acknowledged that Stagecoach subsequently withdrew most of its routes from Glasgow before re-entering with three new high-frequency services in 2015. This withdrawal (which, in any event, was followed by re-entry) does not, however, change the analysis that (i) the joint ownership of FirstBus and SBH did not deter Stagecoach from entering Glasgow either in 1997 or subsequently; and (ii) there is no reason to believe that the combination of SBH with FirstBus’s operations elsewhere in Scotland had any effect on Stagecoach’s success in Glasgow in 1997.

4.6 ***Stagecoach has introduced new services in Glasgow City.*** Stagecoach is one of two operators (the other is McGill’s) on the new Fastlink bus rapid transit system linking Glasgow City Centre with the new Queen Elizabeth University Hospital complex from May 2015. The second operator, McGill’s, withdrew from the service in November 2015. The Fastlink corridor is proposed to operate under a statutory quality partnership scheme. Stagecoach introduced a

²² MMC Decision, para 2.65.

²³ MMC Decision, para 2.65.

²⁴ MMC Decision, para 2.61.

²⁵ MMC Decision, para 2.93.

new dedicated Fastlink service, the X1. In addition, Stagecoach have recently started two additional new services in the city, each running every 10 minutes in total and requiring 13 vehicles to operate. The new Stagecoach services compete with First services 15, 16 and 77, of which 15 and 16 are tendered services.

- 4.7 Since Stagecoach's acquisition of the Cumbernauld depot in August 2015, there have been a number of service enhancements as a result of FirstGroup's withdrawal of the competing X5 service. Revisions to the Stagecoach X28 service include operating for an increased period of the day, and a diversion to include the Condorrat estate on its route.

MMC Findings

"Equally, there is no indication in Cowie's evidence that it is interested in taking on FirstBus in Glasgow".

- 4.8 The bus services operated by Cowie at the time of the MMC decision are now part of McGill's (Cowie was rebranded as Arriva in 1997, and McGill's acquired the Arriva bus operations in Scotland in two phases, in 2001 and 2012). Again, contrary to the MMC's expectations, McGill's has grown considerably and competes successfully with FirstGroup.
- 4.9 ***McGill's has significantly expanded its operations in the area around Glasgow.*** McGill's Bus Services was formed in 2001 from the sale of Arriva Scotland West's operations in the Inverclyde region. McGill's expanded to operate a network of routes covering much of Inverclyde, Renfrewshire and the west of Glasgow, before taking over the remaining Arriva Scotland West operations in a £10 million deal in 2012.²⁶ Further expansion followed in 2012, 2013 and 2014.
- 4.10 McGill's previously operated predominantly in the west, but has expanded substantially in Lanarkshire, to the east of Glasgow and has opened a new operating centre in North Lanarkshire.
- 4.11 McGill's has successfully outbid FirstGroup for tenders, for example, winning all contracts that were tendered by the Strathclyde Partnership for Transport after Henderson Travel went into liquidation in 2014. These contracts were worth approximately £10 million for up to 5 years and FirstGroup had expected to acquire a proportion of this work.
- 4.12 McGill's also operated on the new Fastlink bus rapid transit system in Glasgow, but it withdrew this service in November 2015.
- 4.13 McGill's has the potential to use its existing depots as operating bases from which to initiate further competition with FirstGroup in areas where it has previously been absent. McGill's recently announced record profits and

²⁶ This acquisition was reviewed and cleared by the Competition Commission in September 2012 - <https://www.gov.uk/cma-cases/mcgill-s-bus-services-ltd-arriva-scotland-west-ltd-merger-inquiry-cc>.

significant capital investment in new vehicles. It now operates over 400 buses across 110 routes.²⁷

(ii) *Competition in the rest of central and south eastern Scotland*

MMC findings

“As to potential competition in the rest of central and south-east Scotland from large operators, the prospects are poor. Clydeside/British Bus (Cowie) has depots only to the west of Glasgow. Western Buses (Stagecoach) is well to the south-west of Glasgow at Kilmarnock. To the north and north-east of FirstBus across the Forth the two Stagecoach subsidiaries, Bluebird and Fife Scottish, are too remote to affect more than the edges of the FirstBus territory in central Scotland, with or without the merger.” (para 2.67)

- 4.14 ***Stagecoach is a significant competitor and has pushed FirstGroup out of the Cumbernauld area.*** Following a four year period of sustained head to head competition between Stagecoach and FirstGroup, FirstGroup’s losses at its Cumbernauld depot were so heavy, FirstGroup closed its Cumbernauld depot (the depot was recently sold to Stagecoach). FirstGroup also significantly reduced its remaining services in the area to just the X3 and the X5. Stagecoach then increased the frequency of its existing services and introduced new routes to compete with the X5, which became heavily loss-making. FirstGroup withdrew the X5 service following the lapse of the ScotRail undertakings (which had required FirstGroup to continue to operate the service).

MMC Findings

“That leaves competition from Lothian Regional Transport (LRT)... after its experience in South Queensferry and West Lothian it seems unlikely that LRT would engage in intensive competition with the largest bus operator in the UK.”

- 4.15 As is the case with Stagecoach and the former Cowie bus operations, Lothian Buses has significantly outperformed the MMC’s expectations and expanded in direct competition with FirstGroup. The MMC did not expect that Lothian Buses would engage significantly in competition with FirstGroup.
- 4.16 ***Lothian Buses has engaged in significant and intensive competition with FirstGroup and has exerted significant constraints on FirstGroup’s business.*** Lothian Buses has grown significantly and in many places is operating in direct competition with FirstGroup. Between 1997 and 2014 Lothian’s revenue almost tripled from £45.8m to £135.3m. By 2012, Lothian Buses reported that it carried over 2 million passengers per week, in 2014 this number increased to 2.3 million passengers per week on Lothian Buses. In addition, Transport for Edinburgh carries an additional 93,000 passengers per week on Edinburgh Trams.²⁸ Lothian Buses has reported that: “Six million

²⁷ See <http://www.McGill’sbuses.co.uk/McGill’s.aspx>

²⁸ See Lothian Buses 2012 and 2014 annual reports.

*new passengers used Lothian Buses and Edinburgh Trams services in 2014. Three million more on Lothian Buses over the previous year and three million new passengers on Edinburgh Trams”.*²⁹

4.17 Lothian Buses has not been reluctant to compete directly with FirstGroup, as anticipated by the MMC, and instead has successfully expanded at the direct expense of FirstGroup in a number of areas.

(a) FirstGroup closed its Dalkeith depot, which was located close to Edinburgh, in 2012 after posting heavy losses for a number of years in the face of significant competition from Lothian Buses. Public statements made at the time indicate that FirstGroup had told members of the government that “*strong competition from Lothian Buses made it impossible to sustain the services.*”³⁰ Following the exit of FirstGroup, Lothian Buses moved quickly to cover the services that FirstGroup no longer ran.

(b) [REDACTED]

(c) The expansion of Lothian in competition with FirstGroup is evident in shifting market shares:

(i) In East Lothian, FirstGroup’s share of mileage has dropped from 45% in 1996 to 9% in 2015; Lothian’s share has increased from 15% to 89% over the same period.

(ii) In Midlothian, FirstGroup’s share of mileage has dropped from 64% to 15%; Lothian’s share has increased from 25% to 84% over the same period.

4.18 FirstGroup has also lost a significant share of mileage in Edinburgh; decreasing from 25% to 2% while Lothian’s share has increased from 67% to 89%. Although the MMC did not identify a theory of harm relating to Edinburgh, developments within the Edinburgh area are important for the performance of FirstGroup’s services within the Midland Bluebird and Lowland area, particularly for services that either operate between the Edinburgh area and the Midland Bluebird and Lowland area, or operate close to the boundary of the two areas. For example, with the development of the Edinburgh tram, and Lothian’s integration of its bus operations with the tram routes, FirstGroup has lost business as passengers have switched to Lothian

²⁹ Transport for Edinburgh Annual Report 2014 at p. 1; available online: http://lothianbuses.com/assets/files/Annual_Report_2015v1.pdf

³⁰ <http://www.dailyrecord.co.uk/news/business-consumer/200-jobs-face-being-axed-1118344>.

³¹ As set out in [REDACTED]

services that allow them to switch to the tram in Edinburgh (as explained below, these services also offer the advantage of sharing a ticketing service with the Edinburgh tram)³².

- 4.19 The undertakings were put in place to address a concern that the combination of FirstBus and SBH would result in a loss of potential competition between FirstBus and other parties because potential competitors were likely to be deterred from entering into significant competition with FirstBus. In fact, none of the three large operators in Scotland has been deterred from entering into significant competition with FirstGroup and these operators provide a significant competitive constraint. That change in circumstance means that the undertakings are no longer appropriate in dealing with the adverse effect they were designed to address (because that adverse effect no longer exists) and, as a result, the undertakings should be terminated.

FirstGroup has faced significant competition from smaller operators

- 4.20 The MMC did not identify a theory of harm with respect to small operators but noted that “*small operators are ... hardly a serious competitive threat to FirstBus’s operations.*”³³ In the intervening years, not only have large operators not been deterred from entering areas in competition with FirstGroup, but small operators have not been deterred either. FirstGroup notes that in its response to Questions 13 and 14 of the CMA’s RFI it listed 61 examples of smaller competitors entering or expanding in direct competition with its services. In addition, it is clear from the First Scotland East and First Glasgow board reports that FirstGroup regularly monitors the activity of small operators.

5. Any changes in the constraint placed on FirstGroup by other modes of transport such as train and tram

MMC Findings

“We do not believe that competition from cars and taxis is a significant constraint on FirstBus... FirstBus’s argument is stronger in the case of rail and to a lesser extent underground competition. However, since rail travel and bus travel have different characteristics, the extent to which consumers are willing to substitute between travel modes is not clear.”

- 5.1 The MMC did not find that other modes of transport placed a significant constraint on FirstGroup. There have, however, been significant changes in the constraint placed on FirstGroup by other modes of transport since 1996. New transport options such as the Edinburgh tram and a number of new rail lines have been introduced, the ScotRail franchise has been found to constrain

³²

[REDACTED]

³³ MMC decision, para 2.91.

many FirstGroup bus routes, a new tramline has opened in Edinburgh, and the availability and affordability of cars as an alternative to buses has increased.

MMC Findings

“FirstBus has argued that the [rail] network is a highly effective competitor... The extent of this competition is not, however, clear. FirstBus compared links between rail stations with bus services that passed within a mile of those stations. We doubt that very many of those who use the bus would necessarily see these as close substitutes... More generally, given the different characteristics of rail and bus travel ... it does not follow that passengers regard the two modes as competitive alternatives therefore switching between them on the basis of changes in fares. Indeed we have seen no convincing evidence of material price competition between bus and rail.”

Competition from rail and underground services

- 5.2 The constraint from rail services on FirstGroup’s Scottish bus operations has increased since 1996.
- 5.3 ***The Competition Commission found significant competitive overlaps between the ScotRail franchise and FirstGroup’s bus services.*** In 2003, six years after the MMC report, the ScotRail franchise was re-tendered. FirstGroup was awarded the ScotRail franchise in 2004 and, in connection with that award, the CC carried out a detailed Phase 2 analysis of the substitutability of local bus and rail services in Scotland (and Glasgow in particular) following FirstGroup’s successful tender to operate the new franchise. This analysis found greater levels of substitutability than at the time of the MMC report.
- 5.4 The CC found that “... *it is valid to regard train and local buses as at least potentially substitutable on some routes.*”³⁴ The CC identified 35 routes in Glasgow (about 1/3 of FirstGroup’s routes in Glasgow at the time) as giving rise to probable or possible competition concerns due to overlaps with the ScotRail franchise.³⁵ Routes were classified as “possible” problem routes where they could become “probable” problem routes if competitors reduced relative services, or if the patterns of passenger use on the service changed so that overlap flows without effective competitors accounted for more than 10 per cent of route revenue.
- 5.5 FirstGroup notes that the CC found that there were some significant changes between the pre-2004 and 2004 ScotRail franchises, which could in part explain the differences in conclusions reached by the MMC and the CC. For example the 2004 franchise involved tighter regulation of service levels, and

³⁴ ScotRail decision, para 4.28.

³⁵ ScotRail decision, Appendix G, p. G14-G15

came at a time of changes to regulation of rail fares. Moreover, the Scottish Executive procured 29 new trains to support improvements in service levels.³⁶

5.6 This change in circumstances was confirmed by the analysis carried out by the CC in the MIR report. In the CC's final report in the MIR, Glasgow was the large urban area in which rail or tram imposed the greatest constraint on bus operations. Only 35.8% of bus routes in Glasgow were identified as "not constrained by rail or tram", compared to 46.8% to 95.7% in other large urban areas.³⁷

5.7 ***There are a number of unique features of the new ScotRail franchise (which commenced in April 2015) that may alter interactions between bus and rail and further increase the competitive constraint imposed by rail on bus.*** These include:

(a) *Stricter fares regulation, with real terms reduction in off-peak tickets.*³⁸ Rail fares are likely to become increasingly attractive: increases in regulated peak fares cannot exceed RPI+0% and increases in off-peak fares may not exceed RPI-1%. In addition, the franchise operator is not permitted to introduce higher increases on any individual fares.

(b) *Off-peak patronage growth targets.*³⁹ The operator faces targets to grow off-peak patronage - if the operator fails to meet these targets, Transport Scotland can require it to implement improvement plans. If off-peak patronage were to fall in absolute terms over a period of three years, it could lead to an "event of default" and lead to termination of the operator's contract to run the franchise. Therefore, the operator is heavily incentivised to seek to divert passengers from other modes, including bus, to rail wherever possible.

5.8 ***Rail services have increased in the area since the MMC decision.*** Three new rail lines have been introduced in Scotland over the past seven years: the Bathgate-Airdrie Railway, the Alloa Railway and the Borders Railway. In addition, the new ScotRail franchise, which went into operation in April 2015, will see real term reductions in off-peak fares, and off-peak patronage growth targets.

(a) *Bathgate-Airdrie Railway:* this route, connecting Glasgow and Edinburgh, opened in December 2010. Improvements along this route, such as the introduction of 1,100 new station car parking spaces, were largely aimed at commuters. As a result of increased competition from the Bathgate-Airdrie Railway, FirstGroup cancelled its X14 Livingston to Glasgow service (once the ScotRail undertakings lapsed and it was permitted to do so).

³⁶ ScotRail decision Appendix C.

³⁷ MIR final report, p. A11(2)-9

³⁸ See Schedule 5.3 of the ScotRail Franchise Agreement.

³⁹ See schedule 7.2 of the ScotRail Franchise Agreement.

- (b) *Borders Railway*: this railway, including four new stations in Midlothian and three new stations in the Scottish borders, opened in September 2015. The railway covers a similar route to FirstGroup’s X95 service, but with a considerably shorter journey time (less than an hour compared to approximately 1 hour and 40 minutes at peak times). Year-on-year analysis indicates that passenger numbers on the X95 are down █████ with on-bus revenue down █████ and concession revenue down █████ Four respondents to the CMA’s consultation in September 2015 indicated 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.⁴⁰
- (c) *Alloa Railway*: this railway, linking Alloa to Stirling, opened in March 2008. It introduced an alternative for bus passengers making the trip between Alloa and Stirling, and also between Alloa and places such as Falkirk. Following the opening of the Alloa rail line, FirstGroup lost passengers on the 15/15A service between Alloa and Falkirk; this was one factor in the decline of this service and the bus service was ultimately cancelled.

New mode of transport introduced since the MMR decision

- 5.9 A new tram service was introduced in Edinburgh on 31 May 2014 that is having significant disruptive effects on existing patterns of bus travel around the city. The tram provides a competitive alternative to bus travel for customers on many routes in the city and Lothian Buses has expanded its service to provide an increasingly “integrated” service with the tram. For passengers, Edinburgh Tram and Lothian Buses work as one, and the Ridacard and on-bus day/week tickets can be used on both services. Other operators, including FirstGroup, are not permitted to participate in the Ridacard scheme, putting them at a competitive disadvantage serving passengers in this area.
- 5.10 As noted above, FirstGroup has lost business as a result of passengers switching to Lothian Buses services that allow them to transfer to the trams in Edinburgh. In addition, the introduction of the tram has increased the costs to FirstGroup of operating within Edinburgh due to delays being encountered by buses and other traffic caused by traffic light signals being altered to give the tram priority.

⁴⁰ Decision statement, para 11(d)

Competition from cars and taxis

MMC Findings

“There are... major differences between them in respect of price and convenience, while for many bus users the option of using cars is not available ... they are not sufficiently substitutable by bus users to provide an adequate curb on the prices of bus operators.”⁴¹

- 5.11 ***Car ownership has increased significantly in Glasgow.*** Although the MMC found that only around one third of households in Glasgow owned a car, the 2011 Scottish Census indicated that 49% of households in Glasgow City had at least one car or van available, an increase of nearly 50% compared to the 2001 census⁴¹.
- 5.12 ***There is substantial new evidence supporting the constraint exercised by car transport on bus transport.*** Illuma conducts a monthly survey of FirstGroup bus passengers. The survey includes a question modelled on the survey conducted by the CC in the local buses MIR, which asks: *“If you had been unable to make your journey today by bus, which mode of transport would you have used instead or would you not have travelled at all?”*. The Illuma survey results show substantial switching rates between bus and car 44% of respondents across the undertakings area responded that they would switch to traveling in a car as a passenger and 6% responded that they would switch to traveling in a car as a drive. Therefore close to half of FirstGroup bus passengers in this area identify the car as the next best alternative to the bus.
- 5.13 FirstGroup’s competitors across the UK consistently point to the car as a competitive constraint in their public documents:
- (a) *“The Group regards its primary competitor as the private car and aims to encourage modal shift from car to public transport.”* (Stagecoach 2014 Annual Report)⁴²
 - (b) *“Active competition comes from national and local bus operators, as well as private car and rail.”* (National Express, 2014 Year in Review)⁴³
 - (c) To counter the risk of losing business to other modes of transport, Go-Ahead indicates that it will *“Provide convenient, value for money services offering cost effective alternatives to the private car.”*⁴⁴

⁴¹ MMC decision, para 4.73 and Table 4.8.

⁴² Stagecoach Annual Report 2015 at p. 3. Available online: <http://www.stagecoach.com/~media/Files/S/Stagecoach-Group/Attachments/media/publication-financial-reports/ar2015.pdf>

⁴³ National Express, 2014 Year in Review at p. 7; available online at: <http://nexgroup.blob.core.windows.net/media/2293/ar2014-full.pdf>

⁴⁴ Go-Ahead Group annual report 2014 at p. 36; available online at: <http://www.go-ahead.com/en/investors/results-reports-presentations.html>

- (d) In the assessment of its acquisition of Arriva Scotland West, McGill submitted “*that competition from cars should not be ignored and that rail was likely to provide a competitive constraint.*”⁴⁵
- 5.14 FirstGroup, in fact, actively advertises its bus services in competition with the private car.⁴⁶
- 5.15 ***The availability of taxis in Glasgow has increased.*** The original decision noted that there was “*approximately one taxi for every 193 of the population [in Glasgow] although, if private hire taxis are excluded, this proportion falls: there is one registered taxi for every 436 people in the area.*”⁴⁷ By 2010, this number had risen to one taxi for every 139 members of the population, or one tax for every 415 members of the population if private hire taxis are excluded.⁴⁸
- 5.16 The Glasgow City Council granted Uber a one-year license in October 2015; this development should increase the availability (and lower the cost) of private hire cars for individuals seeking transport in Glasgow.⁴⁹ FirstGroup notes that the CMA has recently considered the positive effect that services such as Uber have had on competition in the taxi and private hire vehicle (PHV) markets.⁵⁰ In particular, the CMA has highlighted benefits to the consumer such as new, innovative services (for example, app based booking systems) which are driving efficiencies: lowering prices and increasing responsiveness to demand.⁵¹
- 5.17 The development of this market in Glasgow will have a knock-on effect for other modes of transport, making taxis and PHVs a more attractive alternative to the bus than previously considered, due to their more competitive pricing and comparative convenience. The new ‘pool’ or ‘ride-sharing’ feature of app-based PHVs such as Uber^{52 53} will further impact the bus market, allowing users to reduce the cost of their fare by sharing the journey with another individual taking the same route. Therefore, the recent changes to the taxi and PHV market in Glasgow are likely to have an impact spanning other modes of transport, such as the bus, as they offer innovative services and subsequently reduce the cost to the consumer.

⁴⁵ CC decision, para 5.8.

⁴⁶ See sample advertisements provide at RFI Response Annex Question 18 (a) to (d).

⁴⁷ MMC decision, para 2.39.

⁴⁸ Based on Scottish Transport Statistics No. 29: 2010 decision (available online: <http://www.gov.scot/Publications/2010/12/17120002/20>) and the 2011 population of Glasgow, which was 592,820 (based on National Records of Scotland 2011).

⁴⁹ See: <http://www.bbc.co.uk/news/uk-scotland-glasgow-west-34549135>

⁵⁰ CMA response to TfL’s private hire regulations proposals, 2 December 2015.

⁵¹ Paragraph 6, CMA response to TfL’s private hire regulations proposals.

⁵² <http://www.theguardian.com/technology/2015/dec/09/uber-uberhop-bus>

⁵³ The CMA encouraged TfL to consider the benefits of ridesharing to consumer, at paragraph 26 of the CMA response to TfL’s private hire regulations proposals.

Summary

5.18 The MMC did not identify a significant constraint on FirstGroup from other modes of transport. In the intervening years, the constraint from each of rail, tram and car (including taxis and private hire cars) has increased in the undertakings area. Even if the CMA were not satisfied that these increased constraints on their own amounted to a change in circumstance that warranted release of the undertakings, they further augment the significant increase in the constraints provided by competing bus operators with do amount to a change in circumstance warranting release of the undertakings.

6. Impact of regulation (such as changes to the Bus Service Operators Grant, concessionary fare repayments and vehicle accessibility requirements) on the level of actual and potential competition

6.1 As FirstGroup set out in its application for release of the undertakings there have been a number of substantial changes to the regulation and funding of local bus services since the undertakings came into force in 2002. In particular, FirstGroup notes that changes to BSOG have increased the cost of operating local bus services at a substantial distance from the depot in which they are based. FirstGroup notes that this view has been echoed by other respondents to the CMA's consultation.⁵⁴

6.2 Despite these substantial changes in the regulatory landscape, FirstGroup has continued to face strong actual and potential competition from a range of operators – both large and small – across the areas covered by the undertakings. In particular, FirstGroup notes that in some instances (e.g. the Fastlink corridor in Glasgow), intervention by local government has created opportunities for entry or expansion.

6.3 Although FirstGroup does not believe that regulation is having a significant effect on entry or expansion in general, as a result of the undertakings, changes to regulation are having a disproportionate effect on FirstGroup. FirstGroup, unlike other operators, lacks the flexibility to respond to regulatory changes. At least one bus operator during the CMA's first round of consultation noted that it had responded to these changes using commercial flexibility that is not available to FirstGroup as a result of the undertakings, telling the CMA: *“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 [the CMA] 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.”*⁵⁵

⁵⁴ Decision statement, para 13.

⁵⁵ Decision statement, para 13.

7. Whether, and to what extent, the undertakings themselves may be having a distortive effect on competition or causing other consumer detriment by reason of changes in circumstance.

7.1 As explained in FirstGroup’s application, the undertakings are likely to deter entry and expansion, and to require FirstGroup to operate unprofitable routes, resulting in a distortive effect on competition.

(a) FirstGroup’s inability, as a result of the undertakings, to cover its efficiently incurred costs either by increasing fares or, in Scotland East, reducing mileage, is set out in detail in FirstGroup’s application. As part of the undertakings, FirstGroup is allowed to increase its prices annually to take account of increases in the cost of providing local bus services as measured by the H-CPT. There has been a persistent divergence between the cost increases FirstGroup, and other operators within Scotland, have actually faced and cost increases as measured by the H-CPT. This divergence has prevented FirstGroup from fully recovering its costs. Below cost pricing in a market risks deterring entry or expansion by efficient operators.

(b) The undertakings require FirstGroup to operate a number of persistently unprofitable services within the Midland Bluebird and Lowland area of Scotland East. [REDACTED]

(c) The forced inefficiency in FirstGroup’s operations in Glasgow and Scotland East deters investment by FirstGroup, even where this investment is required (e.g. to comply with the disability access regulations). Consumers would benefit if FirstGroup were able to cover the costs associated with investments in initiatives such as accessibility, smart ticketing and other customer facing technologies.

7.2 Other commercial bus operators have publicly acknowledged the importance of flexibility in pricing and mileage for operating efficiently.

(a) In its annual report, Stagecoach explains that its business model involves being sufficiently flexible to respond to market developments and changes in demand. The key features of its model include: *“an emphasis on lightly regulated bus operations enabling management to vary prices, operating schedules and timetables in response to developments in each local market without significant hindrance from regulation, and a flexible cost base whereby operating mileage and operating costs can be flexed in response to changes in demand.”*⁵⁶

⁵⁶ Stagecoach Annual Report 2015 at p. 6. Available online: <http://www.stagecoach.com/~media/Files/S/Stagecoach-Group/Attachments/media/publication-financial-reports/ar2015.pdf>

- (b) Similarly, in its annual report, Go-Ahead describes key market features as including the fact that “[o]perators largely make their own decisions, such as setting bus fares, routes and service frequencies” and that “[o]perators have a relatively flexible cost base which can be adapted to mitigate external factors.”⁵⁷
- 7.3 The undertakings prevent FirstGroup from responding efficiently to market developments and changes in demand in the same manner as its competitors, which are unencumbered by undertakings in the areas where First Glasgow and First Scotland East operate.
- 7.4 The undertakings were designed to address a concern identified by the MMC that the merger of FirstBus and SBH would result in a loss of potential competition between FirstBus and other parties. The fact that the undertakings now prevent FirstGroup from recovering its efficiently incurred costs and to run persistently unprofitable routes, resulting in a likely deterrent to entry or expansion by competitors, is a significant change in circumstances and strongly suggests that the undertakings should be terminated.

8. Conclusion and effect on undertakings

- 8.1 As set out above, there have been significant changes in circumstances affecting all of the factors on which the MMC based its 1996 decision regarding FirstBus’s acquisition of SBH. The original competition concerns identified by the MMC no longer exist:
 - (a) The MMC was concerned that the merger would lead to a loss of potential competition between FirstBus and SBH because the positioning of their depots would have allowed them to launch new services in each other’s core areas. As explained above, the depots that led to the MMC’s concerns have closed in the face of competition from other operators and, even if the former FirstBus and SBH businesses were operated independently today, they would not pose a significant threat of potential entry in each other’s core areas.
 - (b) The MMC was also concerned that the merger would lead to a loss of potential competition between FirstBus and other large operators because other large operators would be deterred from entering areas in competition with FirstBus. In fact, the three large operators in Scotland: Stagecoach, McGill’s (formerly Cowie) and Lothian Buses have each expanded significantly in competition with FirstGroup and provide a substantial competitive constraint today. The MMC’s concern that these operators would be deterred from expanding in competition with FirstGroup is clearly no longer relevant.
 - (c) The competitive constraints FirstGroup faces from other modes of transport such as the train, tram and the car (including taxis) has increased substantially since 1996.

⁵⁷ Go-Ahead Group annual report 2014 at p. 12; available online at: <http://www.go-ahead.com/en/investors/results-reports-presentations.html>

- 8.2 The test for varying or terminating undertakings is whether the undertaking is no longer appropriate in dealing with the competition problem it was designed to remedy. In the present case, neither of the competition problems that the undertakings were designed to remedy remains relevant today. Given the complete disappearance of these concerns, the only appropriate step would be to terminate the undertakings.
- 8.3 In addition to the fact that the competition problems the undertakings were designed to remedy are no longer relevant, the undertakings themselves are having a distortive effect on competition by forcing FirstGroup to operate persistently unprofitable routes and preventing FirstGroup from recovering its efficiently incurred costs. These effects risk deterring entry or expansion by other operators: creating precisely the risk that they were designed to eliminate. This effect of the undertakings is a significant change in circumstances that indicates the undertakings are no longer appropriate in dealing with the competition problems they were designed to remedy, and indicating that the undertakings should be terminated.