

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. Commenting on whether, for the purposes of the share of supply test used in determining whether the merger qualified for investigation, the revenue from the Centro-supported rail services should be attributed to NEG in calculating its share of public transport passenger services in the West Midlands, NEG considered that the revenue should be excluded because it accrued to Centro and NEG exerted no material influence over those services. Although there was an incentive system in place whereby NEG would take a share of any revenue increase, the share was modest and would never be significant to NEG's business. Centro's revenue should be included in the overall market but not for NEG's account.

7.3. NEG said that it nevertheless had no reason to question the MMC's view that the share of supply test was passed. It noted that Central Trains received some revenue from services involving journeys carried out wholly within the West Midlands which were not Centro services. These were provided as part of longer services.

NEG's strategy and management

7.4. NEG told us that it was highly regarded throughout the public transport industry as a company firmly committed to growing its transport operations with a high level of responsibility and stewardship. Its commendable record in the implementation of integrated transport systems made it particularly well placed to act as steward of Central Trains for the duration of the franchise. The financial targets to which it was committed by the franchise agreement were such that NEG would achieve success only by adopting policies with the clear aim of attracting people out of their cars and on to public transport by providing a reliable and attractive integrated public transport service. 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. It was NEG's clear aim to ensure that, in the competitive battle between public and private transport, public transport would succeed. NEG added that transport integration was not a zero-sum game and that all operators could gain from it.

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 the profitability of the acquired businesses 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. 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.

7.6. NEG explained 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.

7.7. Each of NEG's five TOCs had its own board of directors. The size and number of TOCs which NEG had acquired had led it 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 have an overview of compliance procedures.

WMT's profitability

7.8. Commenting on WMT's high return on sales, NEG said that WMT was a successful company but was not earning monopoly profits. Depreciation charges had been artificially low because a significant proportion of the fleet had been purchased with the assistance of a grant for new buses but this had now been phased out. WMT's current fleet replacement programme was expected to lead to a steep increase in depreciation charges and a material decline in return on sales. Profit growth had been achieved largely through cost savings-in highly unfavourable circumstances because of the rising level of fuel duty-rather than fare increases. Fares had risen only slightly in real terms since WMT's privatization and compared well with those in other urban areas.

7.9. In addition to these factors NEG told us that Birmingham's geography and demography made it a very suitable market for bus services. WMT also provided an exceptional service offering long hours of operation (its first services started around 4.00 am and its last services finished around 1.00 am). It ran very high-frequency services along the major corridors during peak times and had a policy of charging low fares which led to high utilization.

NEG's record as an owner of TOCs

7.10. NEG said that it was committed to providing rail services which promoted excellence and efficiency for the benefit of passengers and taxpayers. It was proud of its record as an owner of TOCs since it acquired the MML and Gatwick Express franchises in April 1996. MML had had a good first year under NEG ownership, with 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 started, plans had been announced to acquire new rolling stock, 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. Gatwick Express had also experienced a good year, with the already high levels of punctuality and reliability having been improved. NEG told us that it had built on the existing high-quality service through a range of measures that included increasing the frequency of services in the evenings, introducing services through the night and ordering 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.

7.11. NEG intended to apply the same approach to the operation of Central Trains. It planned, for example, to improve the frequency of service on the core Nottingham-Birmingham route; to introduce new services and routes (for example, to Manchester Airport from Nottingham, Derby and Stoke-on-Trent); to purchase new trains; to refurbish rolling stock; to invest £1.25 million in improving station security and accessibility; to extend APEX fares to new flows; to introduce initiatives to facilitate ticket purchase and further improve train service reliability and punctuality; and, in partnership with local authorities, to develop new stations and services. NEG was confident that giving high priority to customer needs would encourage passengers to switch to its rail services, many abandoning their cars to do so.

NEG's approach to an integrated transport system

7.12. NEG considered that the breadth of its interests in transport services (covering coaches, buses, airports and trains) gave it a unique perspective on intermodal transport, making it well placed to assist the Government in implementing an integrated transport policy. It believed 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 rail stations and services in partnership with local authorities and PTEs.

7.13. NEG was able to put together teams with multi-modal experience and to cross-fertilize ideas and experience between its different divisions. It was also well placed to try out different ways of co-ordinating and integrating ticketing and timetables. In the West Midlands its ownership of both WMT and Central Trains meant that it could sell one mode's tickets in another's outlets. It noted that where ownership differed, agreement on the price of multi-operator tickets was often a major impediment to such developments.

Overlaps between NEG's and Central Trains' business activities

7.14. NEG submitted that the merger raised no competition concerns in the supply of public transport services. There were three potential overlaps between the business activities of NEG and Central Trains, covering rail/bus, rail/coach and rail/rail:

- (a) some of WMT's bus services overlapped to a very limited extent with Central Trains' local rail services;
- (b) some of NEL's coach services followed routes which overlapped for short distances with Central Trains' services; and
- (c) MML and Central Trains operated three partially overlapping routes, while NLR operated on one route also served by Central Trains.

The overlaps in (a) were mainly within the West Midlands, while those in (b) and (c) arose primarily elsewhere.

Rail and bus

7.15. NEG stressed that, in considering the competitive significance of its acquisition of Central Trains, it was essential to understand that Centro retained complete control over the fares, service levels and structure of Central Trains' local services in the West Midlands. Indeed, NEG had no influence over the competitive and strategic decisions taken by Centro in relation to these rail services. Centro would continue to specify all fares and NEG was compelled to comply with the PSR, with very strong sanctions which could be applied in the event of poor performance. Furthermore, NEG was bound by the Schedule 14 assurances (see paragraphs 7.62 to 7.69) which were designed to reassure Centro of NEG's intention to maintain and develop WMT services in co-ordination with all TOCs and bus operators. NEG was accordingly unable to exploit its joint ownership of WMT and Central Trains on any rail routes contracted by Centro. The revenue from services on overlapping bus and rail routes outside Centro's control was insufficient to raise any competition concerns.

7.16. Even if Centro did not control Central Trains' activities in the West Midlands, all available evidence indicated that local rail and bus services did not compete with each other. Given the growth in car ownership in the West Midlands, and the declining share of bus services in the total amount of travel, NEG believed that the car was the main competitor for local rail services.

7.17. The West Midlands local rail and bus networks had substantially different attributes (see paragraphs 7.24 to 7.35), and the vast majority of bus journeys could not be practically undertaken by rail, even on sections which overlapped with WMT's bus routes.

Rail and coach

7.18. Overlaps between NEL's coach and Central Trains' rail services raised no more competition issues than those relating to rail and bus. On overlapping routes coach services were at most a relatively weak competitor for leisure travel. The majority of overlapping routes were also served by competing TOCs: these exerted much greater influence on rail fares than coach competitors, which had very limited capacity. On some routes NEL faced competition from other coach or bus operators and on other routes Central Trains was acting as a contractor to Centro, or to Nottinghamshire or Leicestershire County Councils.

7.19. There were only four small overlaps on very minor coach journeys where Central Trains faced no direct independent TOC competition and where NEL operated reasonably frequent services, but even here NEL faced important competitive constraints. There were other coach or bus operators running reliable and dedicated services, moderation of competition had been withdrawn for the rail services on two of the routes, and the fact that the point-to-point coach journeys were small parts of longer routes constrained fare and frequency decisions, which had to be made in the context of the services on the non-overlapping sections.

Rail and rail

7.20. NEG said that the Rail Regulator had expressed no concerns to it about the effects of the merger on competition between Central Trains, MML and NLR and the merger, in NEG's view, had no appreciable effects in this regard. Although Central Trains and MML both operated services on short sections of three routes, on one of them MML's revenue was wholly negligible and on the other two it was small. Moderation of competition in any case either did not apply or had been withdrawn on these routes. Central Trains and NLR both operated between Birmingham and Coventry and between Birmingham and Northampton. On the former flow, two other TOCs operated and moreover the Central Trains services were specified by Centro. On the latter, Central Trains' service was *de minimis* at one per day compared with NLR's 17.

The markets for local rail and bus services in the West Midlands

Historical background to public transport in the West Midlands

7.21. NEG said that the West Midlands rail network was the result of the amalgamation of components of the national rail network. Before nationalization two of the main rail companies used Birmingham as a hub in their long-distance networks. The rail network and stations had not been designed to operate as a suburban network as was the case in London and Glasgow, hence stations in Birmingham's suburbs were far apart and did not reflect the centres of population, shopping and employment. Even where stations appeared to be physically close to bus routes or population centres, physical barriers such as cuttings and embankments deterred rail patronage significantly.

7.22. Local journeys in the West Midlands were historically undertaken on the extensive tram network which followed the road network, linking the existing centres of activity and influencing the location of new development, which therefore clustered around the road and not the rail network. The current core bus network largely followed the old tram network and therefore provided good links between centres of activity.

7.23. Local rail services had been established and increased by Centro and British Rail from the 1970s to alleviate growing traffic congestion on commuter roads: for example, the cross-city line had been opened in 1976 and was electrified in the early 1990s. The failure of the local rail network to meet suburban travelling needs had led to the development of plans by Centro in the 1980s to build a network of 12 to 15 light rail routes, broadly following the major bus corridors. The first line was under construction but the plans had been significantly scaled back because of their high cost.

Market description and the nature of competition

7.24. NEG submitted that the different attributes of local bus services and Central Trains' local rail services in the West Midlands meant that they were poor substitutes from the consumer's perspective and therefore operated in wholly separate markets. WMT's prices were consequently not set with reference to local rail fares, which were determined by Centro without consultation with Central Trains. There were important structural differences between the two modes of transport in network density, average journey lengths, journey times, journey purpose and customer profiles.

7.25. Developing these points, NEG said that the bus network was much more comprehensive than rail, with 500 routes and 12,000 bus stops compared with 7 routes and 71 railway stations. The overwhelming majority of bus journeys could not be made by train, and even where services did overlap it was only to a

small extent. The proximity of customers to either a bus stop or railway station was the key to the selection of mode.

7.26. Bus journeys were far shorter than those made by rail, averaging 4.5 km compared with 10 km, and the limited number of railway stations therefore precluded most bus journeys from being undertaken by a parallel rail route. Bus journey times were generally much longer than for equivalent rail journeys and bus journeys were inherently less punctual, operating as they did on congested roads rather than on dedicated tracks. The nature of bus and rail services meant that they were not close substitutes for travel on longer journeys. Many passengers travelling into Birmingham by local rail services came from surrounding towns such as Solihull, Sutton Coldfield and Wolverhampton. Such journeys took 15 to 20 minutes by rail but about an hour by bus (for example, buses between Birmingham and Wolverhampton were scheduled to take 65 to 76 minutes and rail services 15 to 20 minutes). Only 0.8 to 2 per cent of bus passengers on these three routes made end-to-end journeys.

7.27. Local rail services were used predominantly for commuting whereas bus services were used more for off-peak travel such as shopping and leisure trips. While 59 per cent of Centro-supported rail journeys were made at weekday peak times, only 43 per cent of bus journeys were made at these times.

7.28. The customer profiles of local rail and bus users were substantially different: 40 per cent of all rail commuters into Birmingham were in the professional and intermediate non-manual socio-economic groups, but the corresponding proportion for bus passengers was only 16 per cent.

7.29. The *de minimis* nature of the overlap between Central Trains' and WMT's networks was clearly demonstrated by the fact that only 1.5 per cent of bus passenger journeys on WMT services were taken between points which were also served by the local rail network.

7.30. Even this overlap substantially overstated the degree of competition between bus and rail because all the available evidence indicated that there was no competition even where similar journeys could be completed using either mode. Bus services were typically considerably cheaper than the (subsidized) fares set by Centro on the overlapping rail services, reflecting the substantially lower costs of operating bus services. WMT's fare structure was broadly similar across the West Midlands, whether or not there were overlapping rail routes. If WMT had been constrained to price with reference to local rail services, such uniformity would not be observed. In addition, WMT did not consider that annual rail fare increases had any effect on demand for bus travel, nor that the rail timetable influenced the bus timetable. The structures of the bus and rail networks meant that on all the overlapping routes at least 79 per cent of bus passengers travelled between points not served by the rail network.

7.31. NEG said that while WMT had no database of the fares of other bus operators in the West Midlands, it did monitor competitors' fare levels for marketing purposes. From this evidence NEG believed there was extensive price competition between bus operators in the West Midlands across the range of ticket types offered. It added that it was difficult to assemble comprehensive information about competitors' fare scales; WMT's perception was that some adjusted their fares frequently.

7.32. WMT's policy of having standardized fares for all routes made them easier for passengers to understand, particularly as many used more than one route. Although special offers were made on a variety of routes to stimulate demand, these were not necessarily in response to competition. WMT would respond to market conditions where it believed that price reductions could stimulate additional traffic, but it did not engage in policies which it expected to be loss-making: this would be wholly inimical to NEG's commercial policy, and it would not deliberately do so with a view to eliminating competition.

7.33. WMT's limited stop services on the Cannock-Walsall-Birmingham and Coventry-Birmingham routes did not follow WMT's general fare structure: fares on these services were about 10 per cent more expensive than the comparable standard fare. This was the opposite of what one would expect if local rail competition was an important competitive constraint on such routes. Even these services also served local areas and were much slower than the equivalent rail journey. For example, the Coventry-Birmingham limited-stop bus service was scheduled to take 62 minutes, more than twice as long as the rail service.

7.34. While the revenue-based incentive scheme gave NEG an interest in incremental revenue from Centro-supported rail services, NEG pointed out that if patronage of Central Trains' services were declining,

for example as a result of competition from other TOCs, the scheme might not be triggered even if additional passengers could be encouraged to switch from bus to rail. There was in any case no guarantee that passengers would do so as a result of a reduction in services or an increase in fares on overlapping bus routes.

7.35. The Midland Metro light rail system would operate in a different market from bus services for broadly the same reasons as heavy rail. Buses carried people for short journeys and, because of the nature of the road network, the kind of journeys which the Midland Metro facilitated were difficult or inconvenient by bus. For some journeys, therefore, there would be very large differences in journey time between Midland Metro and bus, and other journeys would not be made by bus.

Competitive constraints faced by Central Trains and WMT in the West Midlands

Competitive constraints faced by Central Trains

7.36. The main competitive constraint faced by Central Trains' local rail services, which were used predominantly for relatively long-distance commuting, was from the car. Whilst there were other TOCs which provided local rail services, they did not compete on price as all interavailable fares were set by Centro. NEG stressed that rival TOCs operating in the West Midlands would materially increase the number of trains operated as a result of franchise commitments to expand services. For Central Trains' services which were not Centro-supported, the service frequency was specified in detail in the franchise agreement.

Competitive constraints faced by WMT

7.37. NEG maintained that WMT's market share in the West Midlands, at nearly 75 per cent of mileage, did not confer a position of dominance in the sense of its being able to act independently of its customers and competitors. Less than 1 per cent of WMT's revenue came from bus services on routes which extended beyond the West Midlands. It was surrounded by major competitors with strong positions in these areas, particularly FirstBus, Cowie and Stagecoach, and these groups had repeatedly demonstrated their willingness to enter new markets. They had a combined market share in the West Midlands of some 7 per cent and their ability to operate express bus services along Birmingham's main radial routes posed a major potential competitive threat. They had local depots and access to major financial backing and expansion opportunities. There was also a significant number of independent local competitors with fleets ranging from one or two buses up to around 70.

7.38. If NEG tried to move passengers from bus to rail, for example by reducing the level of bus services, both small and large competitors would fill the gaps very easily. WMT aimed to provide a comprehensive service and, although it could operate more profitably in the short term by reducing services, such a policy would be disastrous in the longer term. NEG told us that in the mid-1980s some gaps had been left in services operating in the Black Country and this had attracted many small operators, some of which had become larger independent operators.

7.39. In contrast with its share of total mileage, WMT supplied only some 45 per cent by service km of Centro's tendered bus services. The tendered services sector provided a secure business base which facilitated entry or expansion into West Midlands commercial services for new or growing operators. The degree of competition for such services had been reflected in a fall in the cost per km from 52p in 1986 to 37p in 1996. The Centro concessionary fares scheme for senior citizens and children provided major potential income for new entrants as all operators were entitled to a share of such income, calculated by reference to the usage of their services.

7.40. In practice the bus market in the West Midlands had proved highly contestable. WMT's 14 percentage points decline in market share since deregulation in October 1986 demonstrated that barriers to entry and expansion in the West Midlands bus market were not high. NEG argued that the decline would have been considerably higher had WMT not offered highly attractive services. It had substantially reduced controllable costs, enabling fare increases to be moderated; developed its services; and invested substantially in improving the quality of the bus fleet. Customer satisfaction was very high. Notwithstanding this, there had still been numerous successful small entrants.

The markets for coach and rail services

7.41. NEG believed the car to be the most important source of competition to TOCs. Discounted rail fares were aimed primarily at attracting this business rather than the relatively small number of coach passengers, particularly in view of the local and national rise in car ownership. NEL's coach capacity was small in comparison with rail, and the services were typically inferior in journey times, reliability and frequency. As an example, NEL's six daily coaches which operated between Manchester and Sheffield had a maximum seating capacity of 288 compared with Central Trains' daily capacity on the route of some 2,040. NEL's services were all part of longer routes and only a fraction of its capacity would be available for passengers making journeys only between these points. The fastest scheduled journeys were 85 minutes by coach and 51 minutes by train, with coach services being more prone to delay, especially in adverse weather.

7.42. In looking at coach/rail competition on the main overlaps where no other TOCs operated, NEG said that it was difficult to envisage how leisure rail fares had imposed a material constraint on coach fares given that rail fares had generally risen at a faster rate. Indeed, NEL's fares on these journeys were, by and large, its standard network rates which applied even where there were no overlaps, and any departures from these fares were primarily due to local coach/bus competition.

7.43. Coach and rail services were only indirect and partial competitors on overlapping point-to-point journeys and they would compete at most in relation to lower-cost rail fares targeted at leisure passengers. Coach services were a relatively weak competitor in this market sector as there were substantial differences between rail and coach services. Coach services were generally slower, less punctual and less frequent. On the other hand, coach had advantages in terms of greater passenger security because of the proximity to the driver and his ability to help passengers with their bags. On overlapping routes where there was a major rail competitor, NEG submitted that competition from other TOCs had a substantially greater influence on rail fares than competition from coaches. Mergers between TOCs and coach operators would therefore not have a material effect on the competitive structure of the market, or on leisure rail fares or coach fares. Similarly, any hypothetical concerns arising from the elimination of an independent coach competitor-via a merger with a TOC-were likely to be even less significant if another directly competing coach/bus operator remained on the routes affected.

Competitive and regulatory constraints faced by NEL and Central Trains

7.44. There were alternative rail, coach and/or bus competitors on the majority of the overlapping point-to-point journeys, and the degree of rail/coach competition varied between routes. On some routes NEG had no control over rail fares and services, namely Coventry-Birmingham, Coventry-Wolverhampton, Birmingham-Wolverhampton and Nottingham-Mansfield.

7.45. On a number of overlapping routes NEL faced competition from dedicated local coach/bus services which had a number of competitive advantages over its own services, which were all provided as parts of longer routes. Local services were more punctual and reliable, particularly at certain times of the day or year. Timings on longer routes were more prone to delay and where this occurred such delays were relatively substantial in the context of shorter sections of these journeys which were scheduled to take under an hour. Coach/bus services dedicated to shorter routes were more attractive as, unlike for NEL, passengers did not need to buy tickets in advance and could purchase them from the driver, which was more convenient and saved time. A further advantage of dedicated local services was that they permitted passengers to be dropped off and picked up nearer their homes, saving journey time and additional travelling costs. NEL's services generally operated only between city centres.

7.46. Commenting on whether it could reduce rail services on overlapping journeys to increase coach patronage, NEG told us that, of the 13 main routes on which NEL and Central Trains services overlapped, the level of rail services on four were determined by Centro or Nottinghamshire County Council. On the remainder, services were generally operating at the level of the PSR and could not therefore be reduced without the franchise agreement being breached. Even if it were possible to run fewer trains Central Trains would still have to bear a major proportion of the costs because it would be left with surplus rolling stock

and a commitment to the large fixed element of Railtrack's track access charges. Service withdrawals would also have an adverse effect where overlapping sections were part of longer routes. Furthermore, few passengers would transfer to the coach: most would switch either to other TOCs or to more convenient car travel. In the unlikely event that a significant proportion of rail passengers did switch to coach travel, NEL's services would lack the capacity to accommodate them given that most coach seats were intended for use by passengers on longer journeys and that costs would be incurred in adding capacity.

7.47. Withdrawing coach services or increasing fares on overlapping services to increase patronage on Central Trains' services would be counter-productive and would reduce overall profitability. It would have adverse effects on patronage and coach profitability because it would encourage passengers to change their habits and permanently reduce their frequency of travel or switch to car travel. It would not reduce costs in the short term as payments to contractors were fixed for a year. In the longer term it would reduce revenue to a disproportionately greater extent because reducing service frequency made timings less convenient for many customers (who would have to wait longer if they missed a coach) and this materially reduced demand. As with train services, the withdrawal of coach services would have substantial adverse effects where the overlapping sections were part of longer routes.

Potential competition from other TOCs

7.48. Central Trains, as with all other TOCs, had been granted a degree of protection from entry by other TOCs on a number of routes where it operated. On many jointly-operated flows, existing operators could increase services during the period of moderation of competition. In addition the Rail Regulator had signalled his intention in June 1997 to remove protection on routes where Central Trains operated alongside MML. The effect was to make the flows between Leicester, Nottingham, Derby and Sheffield open to any TOC. On the Birmingham New Street-Coventry corridor, where Central Trains operated alongside NLR, a number of TOCs operated with none being particularly prominent, and the Rail Regulator had indicated that he would not be changing the current moderation arrangements there.

7.49. Moderation of competition did not apply where TOCs offered coach services to compete with other TOCs' rail services. GNER already offered a non-stop coach service between Newark Northgate and Lincoln in competition with Central Trains and NEG understood SW&W to be considering operating a service between Aberystwyth and Carmarthen station which, if introduced, would be a significant competitor for rail business to London and the south of England.

7.50. Central Trains' geographical location meant that it was surrounded by many other TOCs so that, when the current level of moderation of competition was reduced in April 1999, an atypically large number of TOCs might be interested in providing competing services on its routes. In addition Central Trains had a very large number of currently protected flows and it was unlikely that any one TOC could introduce sufficient competing services to reach the threshold. There would consequently be material scope for a number of TOCs to develop competing rail services.

Point-to-point journeys on which NEL and Central Trains faced no current independent rail competition

7.51. NEG said that there were only four routes where fares and service levels were not determined by Centro or Nottinghamshire County Council and where there was no competition from non-NEG TOCs: Sheffield-Nottingham, Nottingham-Leicester, Coventry-Leicester and Birmingham-Leicester. But there were competing coach or bus operators on all these routes, which had a number of competitive advantages (see paragraph 7.45). It estimated NEL's annual turnover on these routes to be about £280,000. Even on these very minor point-to-point journeys, however, Central Trains and NEL faced additional important constraints.

7.52. Moderation of competition no longer applied on the first two flows and after 31 March 1999 there would be considerable scope (subject to relaxation of moderation of competition) for new rail competition to be developed on all other routes. Commercial services might be viable for TOCs which had spare rolling stock, had purchased surplus rolling stock from the ROSCOs on highly competitive terms or had negotiated track access rights with Railtrack at low marginal costs.

7.53. NEL's fares on these journeys were set according to its network fare grids, so that any non-standard fare would distort fares to the next point(s) on the routes. There were no non-standard fare offers other than day return fares introduced in response to competition from Stagecoach and Cowie. There had been only two examples of material changes in times and service frequencies on the routes during the previous three years: otherwise the services were virtually as they had been ten years ago, with only a few small timing adjustments to account for traffic delays.

Competition between Central Trains' rail services and NEG's existing rail interests

Competition between Central Trains and Midland Metro

7.54. NEG, through WMT, owned one-third of Altram, the Midland Metro concession company, and had a contract for its day-to-day operation, while the services and service levels had been specified in detail by Centro via the concession deed. The project was essentially aimed at capturing car users and had been justified to the Government—the principal source of finance (via Centro)—on the basis of mode shift from car to light rail.

7.55. Altram was responsible for marketing and fares policy but would be constrained by market forces. NEG said that the Altram board would set fares to meet the requirements of its business plan; no final decision had yet been made on their level. The principal need was to cover operating and capital costs. This would require the attraction of a large number of passengers, a high proportion of whom currently travelled by car, and this factor would be a major constraint on Altram's fares policy. NEG said that WMT as the operator had no influence or control over fares, policy or marketing.

7.56. Apart from a section of line between The Hawthorns and Birmingham Snow Hill stations where Midland Metro ran parallel to the railway, it followed a different route from Central Trains' rail service and was intended to provide new local links. While in theory the Midland Metro might be used for end-to-end journeys between Wolverhampton and Birmingham, only a very small proportion of passengers was expected to do so, as the journey would take approximately 35 minutes compared with 15 to 25 minutes for heavy rail (depending on the number of stops). NEG noted that Virgin and North Western Trains also operated on this route.

7.57. NEG stressed the substantial degree of control exerted by Centro over Midland Metro. Centro defined minimum service levels for the duration of the contract (23 years), required Altram to participate in Centrocard and had established a penalty system for failure to achieve defined operational and quality standards. NEG considered that this overlap was, in the circumstances, *de minimis*.

Competition between Central Trains and MML and NLR

7.58. Central Trains' and MML's services overlapped on three main routes: Nottingham-Derby; Nottingham-Alfreton-Chesterfield-Sheffield; and Nottingham-Leicester. Moderation of competition had now ceased to apply on the last route and had never protected the other two. NEG considered there to be material scope for the introduction of commercially-viable rail services on these routes.

7.59. On the Nottingham-Derby route, NEG said that the frequency and timing of MML's services made them very poor substitutes for those of Central Trains. Between Chesterfield and Sheffield, RRNE and Virgin operated a substantial service. While no other TOCs operated between Nottingham and Sheffield (via Alfreton and Chesterfield), MML's annual turnover on this route, at some £[*], meant that the overlap raised no appreciable competition issue. Between Leicester and Nottingham MML's annual revenue was in the region of only £[*].

* Figures omitted. See note on page iv.

7.60. Both Central Trains and NLR operated frequent services between Birmingham and Coventry, but Virgin also did so and Centro in any case determined the rail fares. Virgin's services, furthermore, had substantially more capacity than those of Central Trains.

Effects of the merger

7.61. NEG considered that none of the overlaps between its existing activities and the services of Central Trains raised any appreciable competition issues. NEG noted that the OFT had not indicated that any customers, competitors or local authorities had expressed any substantive concerns in relation to the merger, although Centro had raised some concerns in connection with rail and bus services in the West Midlands. NEG said that Centro's concerns were surprising in view of the Schedule 14 assurances which Centro had sought and to which NEG had agreed.

Assurances given by NEG to Centro for the protection of local bus services in the West Midlands

7.62. NEG told us that, during the course of the tendering process for Central Trains, Centro had indicated that its support for the bid was conditional on NEG giving assurances in relation, among other things, to the provision of bus services in the West Midlands. NEG said that it had given these assurances (contained in Schedule 14 of the franchise agreement) in order to reassure Centro of its intentions rather than to address substantive competition issues, and they were not necessary to remedy any loss in competition. They had been the subject of considerable discussion between NEG and Centro and a number of amendments had been introduced in the light of wider competition law considerations.

7.63. NEG had willingly given these assurances because they reflected its own way of running a business in terms of low fares, high service frequencies, intermodal and inter-operator ticketing and better information for passengers. It believed that Centro was satisfied with them and that they addressed any hypothetical concerns Centro had about the acquisition. NEG was therefore surprised that, as it understood to be the case, Centro had subsequently expressed concerns to the OFT.

7.64. On the enforceability of the Schedule 14 assurances in the franchise agreement, NEG believed it had a contractual relationship with Centro. NEG told us that it was content with the terms of Schedule 14 and saw no problems in terms of its ability to ensure that the assurances were effectively carried out. It had willingly given the assurances but they were in any case legally enforceable by Centro on its own as a party to the franchise agreement. The contract had been agreed after extensive discussions between NEG and Centro and in NEG's view the contract offered many comforts to Centro.

7.65. Commenting on the context of Schedule 14, NEG said that Centro had expressed some concern that NEG would use its position as a major bus operator in the West Midlands to reduce its service levels on parallel bus/rail corridors and force passengers on to rail. But even if local bus and rail services competed directly on certain point-to-point journeys (which NEG believed was not the case) it would not be commercially sensible for WMT to withdraw bus services on these routes. It would lead to a very substantial fall in revenue from travel between intermediate points which were not on the rail network and which accounted for the vast majority of WMT's passengers. It would encourage one of more than 50 competitors to introduce or increase services, so that WMT could not force passengers to use rail. The value of WMT's travel cards would be reduced, with adverse effects on demand for WMT bus services on its other routes. Centro took all the base revenue from Centro-supported rail services (NEG benefited from only a transitory share of any revenue increase) and rail capacity limits meant that accommodating additional peak-hour passengers might necessitate the use of additional rolling stock, leading to incremental costs substantially higher than the costs of carrying such passengers by bus.

7.66. One of the assurances was intended to prevent confidential information about Central Trains being passed to WMT. Although NEG would ensure that no such information was transferred, it did not consider that such transfers would in any case allow WMT to gain a competitive advantage over Centro-supported rail services because bus and rail were not close substitutes, and the management and operational factors affecting the two businesses were wholly different. The scale of operations was also substantially different, with WMT carrying over 300 million passengers annually compared with an estimated 12 to 15 million for

Central Trains. Central Trains did not currently produce detailed information allowing it separately to identify passenger flows on sections of route which overlapped with bus and NEG presumed that this reflected a belief that such information was not relevant to Central Trains' competitive strategies.

7.67. In another assurance NEG had agreed to provide information to the public, to Centro's reasonable satisfaction, about the services of other bus and rail operators serving Centro railway stations. This was in any case a central part of NEG's franchise bid and was designed to increase the overall use of bus and rail transport.

7.68. The other assurances related to the provision of services across the entire Centro area, not just on overlapping route corridors, and were therefore not linked to any hypothetical competition issues related to the bid. NEG had undertaken that WMT would maintain service and frequency levels at or above WMPTA's minimum standard and would maintain its involvement in Centrocard, which WMT had always accepted on its buses and intended to develop in conjunction with Centro.

7.69. NEG's policy was to improve services and standards to grow the public transport market in general, and it believed that WMT's comprehensive network offered major benefits both to passengers and to the general public. The integration of bus and rail would be highly beneficial and, while NEG hoped to benefit from this, other operators would also benefit. It had therefore been prepared to give these assurances merely to reassure Centro of its own policies.

Local rail and bus

7.70. NEG maintained that the overlap between WMT's local bus services and Central Trains' train services would not lead to a significant reduction in competition. NEG's position as a subcontractor to Centro would not affect the negligible existing competition, and the merger itself could not enable WMT to raise bus fares as Central Trains would not be able to increase rail fares on Centro's services. Even if local rail fares did presently constrain bus fares, the mere fact of NEG providing services to Centro's specification did not relax this constraint.

7.71. Any competition implications of the bus and rail overlap would at worst be limited to those routes where Central Trains had some influence over fares, but WMT's and Central Trains' revenues from such services were wholly *de minimis*. Accordingly, NEG submitted that the merger had not led to any loss of competition, or risk of bus and rail fares rising as a consequence.

7.72. For similar reasons NEG considered that there was no risk of the merger enabling it to increase its profits by ceasing to provide bus services on overlapping routes. Such actions would lead to a substantial fall in revenue where journeys could not practicably be undertaken by rail. NEG told us that bus service reductions would have a disproportionately large effect on the demand for such services because they would reduce the attractiveness of public transport relative to highly convenient car travel. The bus routes in question were among the most heavily used in the West Midlands and WMT's actions were governed by strong competitive constraints (see paragraphs 7.24 to 7.35 and 7.65).

Rail and coach

7.73. NEG considered that the overlap between NEL's scheduled coach services and Central Trains' rail services raised no appreciable competition concerns. Any hypothetical competition concerns must be considered in the context of the commercial objectives underpinning the bid, which were predicated on Central Trains steadily increasing the annual revenue from OPRAF-supported services (ie those outside Centro's area) from some £[*] million at present to £[*] million in nominal terms over the life of the franchise. This could certainly not be achieved by NEL stopping coach services on all 13 overlapping point-to-point journeys and increasing leisure rail fares on those journeys to the maximum possible. Such a policy would result in the vast majority of the business affected being diverted to the other TOCs and bus and coach operators which operated on these routes, as well as to car travel.

*Figures omitted. See note on page iv.

7.74. The success of the franchise would depend on NEG winning back market share from more convenient car travel, and marketing and pricing would be targeted at capturing journeys from cars or stimulating new travel. Central Trains was introducing initiatives to increase income, such as reducing fares to attract more passengers, and reductions were being applied across a wide variety of routes, irrespective of any overlap with NEL's services.

7.75. NEG did not consider that there would be any scope for it to withdraw coach or rail services on the overlapping journeys. Accordingly the only relevant issue for these journeys was whether, following the merger, it would be profitable for NEG to increase leisure rail or coach fares on the basis that this would increase its total revenue from its coach and rail business, and NEG rejected this proposition (see paragraphs 7.44 to 7.50).

Rail and rail

7.76. NEG said that the Rail Regulator had expressed no concerns to it about the effects of the merger (see paragraph 7.20). In view of this, the absence of substantive concerns raised with the OFT, and the points raised in paragraphs 7.54 to 7.60, NEG submitted that the merger had not had any appreciable effects on on-rail competition.

NEG's conclusion

7.77. In the light of its evidence on the effects of the merger NEG considered that there was no realistic prospect of any adverse effects on competition or, therefore, on fares, frequency of service or the reliability or quality of public transport services.

Public interest benefits

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

7.79. Operation of the Central Trains franchise by NEG would save some £45 million a year in public subsidy over the life of the franchise compared 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 new rolling stock maintenance activities would be provided. NEG was also committed to achieving a higher level of punctuality and reliability.

7.80. In addition NEG had been required to give assurances to Centro in relation to various matters including the maintenance of bus services operated by WMT in the West Midlands.

7.81. A range of initiatives was planned, to which NEG was committed by the franchise agreement. Thus it was committed to introduce a bus feeder service between Sandwell and Dudley station and Dudley town centre and to a joint promotion, with Centro, of existing park-and-ride facilities. Other commitments included the provision, as a 12-month trial, of a free telephone taxi booking service from three Central Trains stations, an increase in Central Trains' service frequency to Stansted Airport and Birmingham International station (for Birmingham Airport), and a new hourly service between Nottingham and Manchester Airport. NEG was already involved in the Midland Metro light rail system which would complement the existing heavy rail services and be closely co-ordinated with feeder bus services, with through-ticketing.

7.82. A number of innovations and trials were in hand in the area of co-ordinated ticketing and information. NEG was developing jointly with Centro and other bus operators a range of innovations, covering the provision of bus information on rail services and rail information on bus services, improved signs and schedule co-ordination at key bus/rail interchanges, full integrated ticketing with the Midland

Metro and making rail tickets valid on WMT buses in the event of severe train service disruption. Certain Centrocard tickets would be available for sale on WMT buses and bus tickets for all operators would be sold at Central Trains' stations.

7.83. Within the West Midlands, NEG was providing information about all bus operators at all railway stations. It advertised the Centro hotline number on the back of all WMT buses. It was about to put rail maps in all of its buses, together with information about how to contact the Centro and national bus and rail inquiry services. It would shortly introduce the sale of one-day Centrocard tickets on its buses, which could also be bought and used on most other operators' buses and on rail services. Later it would introduce some dedicated bus/rail feeder services. It was intending to review railway station signposting to improve transfer between train and bus, and the review would also look at bus stop positioning and information provision. It would shortly introduce add-on tickets for passengers travelling to the West Midlands by train to purchase unlimited bus travel for a day on all operators' buses. NEG intended to maintain this momentum over the coming years and would seek to identify further opportunities to enhance the public transport network and attract car passengers.

7.84. NEG's activities had given it experience in working with local authorities and PTEs and, in addition to its formal and extensive commitments in its franchise agreement to work with Centro, it would be operating the Robin Hood line on behalf of Nottinghamshire County Council, the Ivanhoe Line on behalf of Leicestershire County Council, and an extended service to the new Rugeley Town station (later to be extended to Stafford) on behalf of Staffordshire County Council.

7.85. The activities and proposals described above not only demonstrated NEG's commitment to achieve integrated public transport systems. They also displayed a commitment and a need, for commercial purposes, to address the real competition in the transport sector: that between public transport and the private car. Only if NEG succeeded in attracting significant numbers of car travellers would its rail franchises succeed. To this end efficiency, quality, reliability and innovation in a fully integrated multi-modal system were essential.

Views on third party submissions

7.86. Several third parties expressed concerns about the merger or about aspects of NEG's services. We invited NEG to respond to some specific matters and, for any concerns not addressed in the preceding paragraphs, its comments are summarized below.

Travel-card schemes

7.87. A group of bus operators, represented by BCC (see paragraphs 6.15 to 6.18), had expressed concerns that WMT's dominance of the local public transport market resulted partly from its own travel-card scheme, in which it sold both regional and sub-regional (zonal) travel cards. The operators said that WMT's scheme had captured a large share of the market and that WMT had refused to participate in a zonal version of the all-operator Busmaster which could compete with WMT's zonal travel cards. We put these views to NEG.

7.88. NEG replied that in the West Midlands there were a variety of travel cards available and that operators other than WMT offered single-operator tickets. It noted that Centro multi-modal travel cards were available on a zonal basis and that WMT enthusiastically participated in multi-operator schemes, selling both Busmaster and Centrocard tickets through its agents and shops.

7.89. The regional Busmaster travel cards were 10 per cent more expensive than the equivalent regional WMT travel cards. The premium reflected the increase in frequency and coverage of the services of the other operators, which provided in total some 25 per cent of West Midlands services by mileage. The Busmaster ticket therefore offered users a 25 per cent increase in service at only a 10 per cent premium. The same principles applied to the fully-regulated London Travelcards, where cards offering fewer services or smaller bus zones were cheaper than full network cards.

7.90. The aim of WMT travel cards was to stimulate demand by providing a discount for regular travellers and they were very popular. Single-operator travel cards were cheaper to provide than multi-

operator cards as there was no need for an organization to agree and monitor pricing and revenue-sharing. In particular high-cost operators preferred to set higher fares than lower-cost competitors.

7.91. Meetings of the Bus Operators Group were chaired by Centro. NEG said that WMT had reviewed the minutes for the past three years but found no record of any operator enquiring about the introduction of zonal Busmaster tickets. NEG said that when WMT had announced its intention, in January 1994, to launch a zonal version of its travel card, Centro had enquired whether a new Busmaster zonal ticket should be introduced. WMT had said that it was not appropriate at that stage and no operator had raised the matter since.

7.92. NEG said that it failed to see how the interests of consumers and competition would be served if WMT did not offer its own travel cards, and that customers should not be compelled to pay more for all-operator travel cards if they did not wish to. Other operators could seek lower prices for Busmaster cards if they considered it appropriate. NEG also noted that it was curious that the desirability of a zonal Busmaster card had not been formally raised at any Bus Operators Group meeting during the past three years. NEG emphasized that many season ticket travel cards were purchased primarily for return journeys on a single route rather than for network travel, and even single-route competitors could compete for this business. The competitive advantage conferred by WMT's own season tickets should not be overstated.

Responses to other concerns

7.93. Responding to an additional concern of the group of bus operators (see paragraph 7.87) that WMT's dominance had also resulted from its acquisition of competitors, NEG said that WMT had acquired the businesses of only three very small competitors since deregulation in 1986. These were Metrowest, Smiths Your Bus and Merry Hill Minibuses, which between them had operated 105 buses. [*Details omitted. See note on page iv.*] the acquisition of Merry Hill Minibuses and the Secretary of State had decided not to refer the merger to the MMC. NEG considered that there were no grounds for believing that WMT had been able to obtain or enhance a position of dominance through acquisition.

7.94. Banga, a bus operator which competed with WMT in the Wolverhampton area (see paragraphs 6.7 to 6.9), told us that WMT had engaged in predatory pricing and other anti-competitive practices, including running buses just ahead of its own services. NEG told us that it had issued discount vouchers on certain long-established routes as an experiment to generate additional cash passengers, not as a response to competition from Banga, but they had not been successful and had been withdrawn. On the timing of buses, WMT always tried to run to schedule but, because of traffic congestion, this was not always possible. Two routes, the 503 and 535, were very frequent and it was inevitable that WMT buses would occasionally run in front of Banga's.

7.95. Cambridgeshire, and Hereford and Worcester County Councils (see paragraphs 6.24, 6.30 and 6.31) were concerned that Central Trains might concentrate resources in the West Midlands to the detriment of the remainder of the network, but NEG considered that there was no risk of such neglect. Its franchise bid was able to offer a steep drop in subsidy only on the basis of increasing fare revenue from OPRAF-supported services. NEG required an annual revenue growth from Central Trains of over [*] per cent in the early years of the franchise and a total of [*] per cent over the life of the franchise, and Central Trains would have to enhance the quality, frequency and reliability of its services outside the West Midlands in order to achieve this.

7.96. GNER, a TOC (see paragraphs 6.2 to 6.4), was concerned that NEG could exploit its dominance of railway stations and bus depots to restrict competitors' ability to develop integrated coach/rail links. NEG responded that it did not seek to restrict coach contractors from providing link services to other TOCs, and it provided open access to all operators seeking to use the very limited number of bus stations which it owned. Indeed, Speedlink (a contractor of NEL) provided feeder services to Heathrow Airport on behalf of South West Trains (owned by Stagecoach). Furthermore, there were many other bus and coach operators capable of providing contracted services to competing TOCs.

*Figures omitted. See note on page iv.

7.97. Ring and Ride (see paragraphs 6.13 and 6.14) considered that the merger presented a unique opportunity to address the travel needs of people with disabilities. NEG said that it was acutely aware of the need for all public transport operators to improve accessibility for those who had difficulty in using traditional bus and rail vehicles. It added that WMT and Central Trains would welcome the opportunity to undertake a joint examination of the possibility for feeder services to conventional bus and rail facilities which could increase travel choice for such people and maximize the community benefit from WMT's £[*] million annual fleet replacement programme.

7.98. NEG told us that WMT's new low-floor buses had already proved popular and had significantly increased travel choice for wheelchair users and other passengers with impaired mobility. Central Trains' Disabled Person's Protection Policy described its detailed policy and it was undertaking improvements in 1997 in line with these commitments. These included setting up a centralized disabled bookings telephone service, the installation of access ramps on all remaining diesel trains without them, improving access at certain stations and adding orange-badge parking at stations as part of any resurfacing or relining works.

7.99. The TSSA (see paragraph 6.62) expressed its concern that economies of scale sought by rail franchisees could be detrimental to both the quality and level of service. NEG said that it had no intention of engaging in acts which would have adverse effects on customer safety or comfort. Notwithstanding the level of subsidy, the franchise agreement committed it to significant improvements in service quality, punctuality and reliability.

Remedies

7.100. We invited NEG to comment on the divestment of all or part of the Central Trains franchise should the MMC conclude that the merger might be expected to operate against the public interest. NEG said that the overlap between rail, bus and coach operations was so modest that such a remedy would be completely disproportionate to any possible detriment. The divestment of all or part of WMT would be an equally inappropriate and harsh remedy.

7.101. On the question of divesting some of the NEL coach services, NEG said that the services were part of much longer-distance journeys and it would be extremely difficult to break the network in the very small corridors where there were modest overlaps.

7.102. [

Details omitted. See note on page iv.

]

G ODGERS (*Chairman*)

D J JENKINS

D P B KINGSMILL

J F PICKERING

P A BOYS (*Secretary*)
30 September 1997

*Figure omitted. See note on page iv.