

### Previous reports involving consideration of rail:coach competition

1. The CC has on three previous occasions considered acquisitions by NEG of rail franchises which involved overlap with NEG's coach services. In brief:
  - (a) In the case of NEG/Midland Mainline (MML report), the merger was found against the public interest, but with behavioural undertakings relating to maintaining the level of coach services and their fares.
  - (b) In the case of NEG:ScotRail, NEG was required to divest its coach services in Scotland.
  - (c) The third inquiry—NEG:Central Trains—considered coach:rail competition on express coach services which overlapped, but only to a limited extent, with some of the services of Central Trains; there were also other train and bus operators on some of these routes. But NEG also owned West Midland Travel, which had a very large market share of local bus services in the West Midlands: hence bus: rail competition in that area was also a main issue of the inquiry. Both aspects of the merger were cleared.
2. A number of detailed aspects of these reports are also of interest in the context of the current inquiry.

### NEG:Midland Mainline inquiry

3. The overlap affected five NEG coach services between London and East Midlands. Three of the services operated at frequencies of five to seven services a day; two operated only once a day (but all main destinations had at least five services a day). This compared with rail frequencies of 16 to 32 services a day. Coach accounted for on average 12 per cent of total passenger numbers between London and the five main destinations served (varying between 7 and 19 per cent); but some 24 per cent of leisure travel (varying between 15 and 26 per cent).
4. During that inquiry, the CC commissioned a study from the ITS at Leeds on price elasticities of rail and coach services, and cross-price elasticities between rail and coach. Since coach travel is primarily for leisure purposes, it was only price elasticities of leisure travel that mattered in that case. ITS put forward a leisure fare own price elasticity of rail of  $-0.9$  and own-price elasticity for coach travel of  $-1.1$ . Even though any elasticity of above 1 implies that attempts at increasing coach fares by, say, 10 per cent would reduce demand by 11 per cent and reduce revenue, we noted that profits would be likely to increase given the scope to adjust the cost of coach services in line with demand: hence the prospect of passengers switching to other means of travel or not travelling at all could not be regarded as providing a strong constraint on increasing coach fares or reducing quality of service.
5. The ITS also derived values of a cross-elasticity of demand for coach services with respect to rail prices of  $+0.3$  (ie if rail prices increased 10 per cent, demand for coach travel would increase by 3 per cent) and of rail with respect to coach of  $+0.14$  (but higher for certain groups, and dependent on initial modal shares). Together with:

- (a) NEG's own survey evidence that most coach passengers choose coach because of lower fares;
- (b) evidence that coach fares were based on a 30 per cent discount from rail fares; and
- (c) evidence that, at the time of coach deregulation in the early 1990s when coach fares were cut, about one-half of newly generated demand was from passengers transferring from rail;

it was concluded there had been an element of competition between coach and rail to leisure passengers, which had been lost as a result of the merger. Because of the absence of other strong constraints on fares or services it was concluded that the merger may be expected to lead, over time, to higher coach fares or higher fares on both coach and rail, and/or a lower quality of coach services or a lower quality of both coach and rail services, than would have been the case had the merger not occurred.

### **NEG:ScotRail inquiry**

- 6. The inquiry considered overlap on 11 routes. The frequency of coach services varied from 3 to 64 services a day (Glasgow–Edinburgh): coach frequencies were generally similar to, or above those of ScotRail. Market share figures were excised.
- 7. The report referred to evidence in the previous NEG:Midland Main Line report of competition between rail and coach, and to evidence specific to the Scottish coach services. It reached a similar conclusion to the MML report of an element of competition between coach and rail services, principally for leisure passengers, that had been lost as a result of the merger. Increases in coach fares were expected on seven routes, and a loss of more vigorous competition, in innovation and quality of service, that may have been expected to develop under separate ownership, on those and another two routes.

### **National Express:Central Trains inquiry**

- 8. In considering the effect on rail:coach competition, the report concentrated on 11 flows where the overlap was regarded as significant, that is where NEL had more than three summer services a day, and on which its annual revenue was more than £20,000 a year. On these flows, the number of Central Trains passengers was significantly greater than the number of NEL passengers.
- 9. The report referred to similar evidence of competition as in the other inquiries; and to other evidence of the effect of fares on choice of rail or coach travel. It stated that, to the extent that there were overlaps between routes served by Central Trains and NEL, that element of competition would be lost as a result of the merger. But on four of the flows, there were competing TOCs present carrying the bulk of rail traffic. Of the other flows there were four with sufficient competition from other TOCs or inter-urban bus services and one with sufficient competition from another bus operator to deter NEG from abusing its position. The remaining two flows were parts of much longer routes, and generated relatively little revenue. Constraints on rail saver return fares were also such that the potential gain from joint exploitation of the situation was unlikely; and there was some possibility of entry by bus operators on one route. The CC could not rule out the possibility of raising fares for leisure passengers particularly on coach; but the commercial incentives were small, and it was not expected to do

so. For similar reasons, there was no expectation that the dynamic benefits of competition would be lost.

## **Other cases**

10. We also noted the Secretary of State's decision in December 2000, on the advice of the OFT, not to refer the NEG:Prism merger. Prism was then the operator of c2c and WAGN, which also operated the Stansted Express service, which competed with coach services between London and Stansted Airport operated by NEL. The OFT was concerned that common ownership of coach and rail services on this route would reduce the competitive constraint on coach fares previously exercised by rail, and provide NEL with greater scope to increase coach fares above the competitive level. It said that this concern arose because, following the merger, the benefit of additional demand for rail services in the event that NEL increased the price or reduced the frequency or quality of its coach services would accrue to NEG itself; other forms of transport such as car and taxi were unlikely to provide a competitive constraint. The OFT recommended, and the Secretary of State accepted, undertakings which National Express was prepared to give, to regulate the coach fares on the London–Stansted route, by tying fares to the coach fares that NEL charged on the London–Heathrow route (where NEL faced substantial competition) and requiring NEL to maintain current frequency levels and agreed service capacity.