
Completed acquisition by Stagecoach Group plc of the South Western franchise

The OFT's decision on reference under section 33(1) given on 27 February 2007. Full text of decision published 8 March 2007.

Please note that square brackets indicate figures or text which have been deleted or replaced at the request of the parties for reasons of commercial confidentiality.

PARTIES

1. **Stagecoach Group plc (Stagecoach)** is an international public transportation group, with operations in the UK, the USA and Canada. It established **Stagecoach South Western Trains Limited (SSW)** for the purpose of pre-qualifying for, bidding for and operating the **South Western Franchise (SWF)**.
2. The **SWF** consolidates two existing passenger franchises, the South West Trains (SWT) franchise, operating in the South and South West of England and the Island Line franchise, operating in the Isle of Wight. Stagecoach currently operates both the SWT and the Island Line franchise through operating subsidiaries. Both franchises commenced in 1996, and have a combined turnover of £687 million for the 2005/2006 financial year.

TRANSACTION

3. The SWF franchise runs for 10 years, commencing 4 February 2007 and expiring in February 2017, with the last three years conditional upon set criteria being met. The merger arises from a competitive bidding process, originally tendered by the Strategic Rail Authority, but which is now managed by the Department for Transport.

4. SSW was notified on 20 December 2005 that it had pre-qualified to bid for the SWF. It submitted its bid on 30 June 2006 and on 21 September 2006 it entered into the Franchise Agreement with the Department for Transport (DfT) to operate the SWF. The Franchise Agreement closely prescribes the services to be operated by SSW. SSW commenced operations on 4 February 2007. The statutory deadline for consideration of this transaction is 1 June 2007.

JURISDICTION

5. The award of a rail franchise constitutes an acquisition of control of an enterprise by virtue of section 66(3) of the Railways Act 1993. Therefore, on 4 February 2007, SSW and the SWF ceased to be distinct. The combined annual UK turnover of the franchises which will make up the SWF exceeds £70 million, meeting the turnover test in section 23(1)(b) of the Enterprise Act 2002 (the Act).
6. Accordingly, the OFT believes that arrangements have been carried into effect, which has resulted in the creation of a relevant merger situation for the purposes of section 22(1)(a) of the Act.

FRAME OF REFERENCE

Product market

7. This acquisition involves overlaps between rail services and other modes of public transport operated by Stagecoach group companies on point-to-point journeys (or 'flows'). The nature of such overlaps has been considered by the OFT and the Competition Commission (CC) on a number of occasions, and hence are dealt with only briefly here¹.

¹ See further discussion, for example, in the CC's decision in *FirstGroup plc and the Greater Western Passenger Rail franchise* (8 March 2006) (First / Great Western); *FirstGroup plc and the Scottish Passenger Rail franchise* (June 2004) (ScotRail); *National Express Group plc and the Greater Anglia franchise* (November 2004) (NEG / Greater Anglia); *National Express Group plc and Thameslink and Great Northern franchise merger inquiry* (December 2005) and in the OFT's decisions in *Anticipated acquisition by South Eastern Railways Limited (a joint venture between DSB and Stagecoach Group plc) of the Integrated Kent rail franchise* (31 March 2005) and *Anticipated acquisition by Virgin Group Investments Limited and Stagecoach Group plc of the Intercity East Coast Mainline Franchise* (31 December 2004).

8. Flows on different public transport services are considered to overlap if they share the same start and end points or if their start (and end) points are within specific distances from each other. The specific distances used in the current case for the purpose of identifying overlapping start and end points (and hence overlapping flows) are discussed further below under each type of overlap considered.
9. A large number of previous inquiries by both the OFT and the CC have involved a combination of rail, bus and/or coach service overlaps. It was considered in each that where passengers have a number of alternative methods for travelling between two points their choice, and hence the extent of demand-side substitution, is a function of a number of factors, including the availability of different modes of transport, fares, and locations of the embarkation and disembarkation points, journey times, journey distance, and the reliability of the different modes of transport. This is referred to as the 'generalised cost' of a journey.
10. As with previous cases, the degree of substitutability between different modes of transport is an empirical question and can vary by geographic area². For the purpose of the current investigation it suffices at this stage to consider all alternative modes of public transport on point-to-point flows to be in the relevant product scopes. The extent to which the alternative modes of transport compete on the overlapping flows identified, and whether the acquisition is likely to result in a substantial lessening of competition on any of these flows, is discussed in more detail in the competition assessment section.
11. Due to the lack of compelling evidence we have not considered the competitive constraint imposed by private modes of transport.

Geographic market

12. In making a journey, passengers wish to travel from a particular origin to a particular destination, and are unlikely to change their route in response to a small but significant and non-transitory increase in price. The competitive assessment in past cases has consistently focussed on point-to-point overlaps. We have received no evidence to suggest deviating from this approach in the current case.

² See, for example, the comparison between cases in First / Great Western, at paragraph 15.

13. As well as providing passenger transport along point-to-point flows which are potentially substitutable, bus and rail operations are to some extent complementary e.g. where bus services are used to travel to railway stations for onward journey by rail. In previous cases³ it was considered that these complementary operations may form broader public transport networks where the transport provider has scope to develop interrelationships, for example by supplying multi-modal tickets valid only on commonly owned transport or by coordinating the timing of services to ensure convenient connections. Regard is also given to broader transport networks in this assessment.

HORIZONTAL ISSUES

Counterfactual

14. Consistent with the CC's approach in First / Great Western,⁴ the CC's most recent decision in relation to a rail franchise, the OFT considers the appropriate counterfactual in the current case to be the award of the franchise either to a company that would raise no competition concerns or to one in respect of which any competition concerns would be remedied through behavioural remedies.
15. The reason why the OFT and the CC consider this to be the appropriate counterfactual in rail franchise cases - as opposed to defining the counterfactual as the pre-merger competitive conditions - is that, as the franchise agreement terminates, it is not possible to reach an expectation that the current operator would continue to operate the franchise.
16. Our expectation in this case, therefore, is that in the absence of the acquisition by Stagecoach, the services would be operated by another TOC raising no competition concerns. This is particularly relevant in this case as Stagecoach is the incumbent TOC. The fact that Stagecoach is the incumbent TOC means that the theory of harm the OFT is required to test is different from that considered in most previous rail franchise cases. Whereas the typical theory of harm is whether the acquisition would result in a lessening of competition on overlapping flows due to the bringing

³ See, for example, First / Great Western at paragraphs 5.109 – 5.111 and ScotRail at paragraphs 4.30 – 4.36.

⁴ *FirstGroup plc and the Greater Western Passenger Rail franchise* (8 March 2006).

together under single ownership of competing modes of public transport, here, where overlaps exist, those modes of transport already are operated by a single company. As mentioned above Stagecoach has operated the SWT franchise since 1996. Therefore, the appropriate consideration in this case should be whether the award of the SWF franchise to Stagecoach again (i.e. the SWT and the Island Line franchise combined) is preventing the introduction of competition on those overlapping flows, which would occur if the franchise was awarded to an alternative, non-overlap TOC. The theory of harm as it applies to the different types of overlap is explained, where relevant, in more detail in the competition assessment section.

The impact of regulation

17. Previous rail franchise investigations have discussed the impact of regulation on the ability of train companies to compete⁵. As in those cases, the SWF franchise agreement is highly prescriptive as to the nature of the passenger rail services to be provided by SSW⁶.
18. The service level commitment is a specification of the level, frequency, maximum journey time and stopping pattern of all of the passenger services to be operated by the franchisee. Only the DfT has the right under the franchise agreement to change the service level commitment. The franchisee can propose changes to the service level commitment but the DfT is not obliged to accept these proposals. The result is that the franchisee will have very limited scope to vary service levels on the SWF. Stagecoach has submitted that the regulation is essentially the same as that used for recent rail franchises.
19. The Franchise Agreement requires Stagecoach to comply with the DfT's standard fares regulation policy. This requires the maintenance of a price cap on two fare 'baskets'. Regulation takes the form of an overall cap on fare increases within these baskets. For the 2002/2003 financial year, Stagecoach submits that [approximately 30] per cent of the SWF fares were directly regulated.

⁵ See, for example, the OFT's decision in Anticipated acquisition by National Express Group plc of the Greater Western Franchise (30 September 2005) at paragraphs s 25 – 27 and the CC's decision in NEG/Greater Anglia at paragraphs 3.4 – 3.9).

⁶ One change from previous investigations is that the DfT, rather than the Strategic Rail Authority, is now responsible for administering the franchise agreements.

20. In NEG/Greater Anglia⁷ the CC found that regulated fares in practice provide some constraint on increases of unregulated fares on the same flows. However, consistent with the theory of harm described above, there is nothing to prevent pricing below the price cap.
21. All regulated fares, and some unregulated fares (where required by the DfT), may be 'compulsory inter-available' (i.e. for use on any train on 'any permitted' route). Stagecoach claims that the vast majority of unregulated fares available on the SWF rail-on-rail overlaps are interavailable. The level of interavailable fare is set by the lead operator on the relevant flow – Stagecoach submits that on the majority of such flows it is not the lead operator.

Rail-on-rail overlaps on point-to-point flows

22. Stagecoach identified 38 flows on which there is a rail-on-rail overlap between the services operated by the SWF and the Cross Country franchise in which it currently has a 49 per cent interest in the parent company of the operating TOC, Virgin Cross Country (VXC)⁸. Each rail-on-rail flows share the same start and end points.
23. Stagecoach submitted that, as it only holds an indirect 49 per cent shareholding in the VXC, it cannot make commercial decisions (e.g. increase unregulated fares or change non-price aspects) in relation to the VXC service offering. However, even if this is the case, Stagecoach is able to make commercial decisions on the service offerings of the SWF and therefore impact on the overall levels of services and/or unregulated fares on the overlapping rail-on-rail flows.
24. Stagecoach also submitted that VXC does not act as a competitive constraint on the operations of the SWF on the overlapping flows, as VXC services are much less frequent than those of the SWF. In addition, First Great Western (FGW) operates on many of the overlapping flows. FGW is the lead operator for fares on the overlapping flows where it operates, and runs much more frequent services than VXC or SWF⁹. Finally, Stagecoach

⁷ *National Express Group plc and the Greater Anglia franchise* (November 2004) at paragraph 7.38(d).

⁸ Virgin Cross Country is a wholly owned subsidiary of Virgin Rail Group Holdings Limited, of which Stagecoach is a 49 per cent shareholder.

⁹ The standard peak and off-peak fares are set by FGW and are inter-available.

argued that all but a very small proportion of revenue on the overlap flows were from interavailable fares, such that there was very little existing competition between VXC and SWF.

25. However, it is not necessary to reach a conclusion on the extent to which the different rail services operated by Stagecoach (or VXC) compete (or might compete) or the extent to which FGW provides a constraint on the overlapping flows. Since the Cross Country franchise is due to expire on 11 November 2007 the OFT will have the opportunity to re-assess the competitive situation on the relevant flows if Virgin Voyager¹⁰ is selected as the franchisee. Any competitive harm that would arise from the overlaps between the VXC and the SWF (or any competitive benefit that might otherwise arise from an operator other than Stagecoach running the SWF) would last no longer than until the commencement of the new Cross Country franchise. Given this relatively short period of time, the OFT does not believe that the rail-on-rail overlaps raise significant competition concerns.

Coach-on-rail overlaps on point-to-point flows

26. Stagecoach has identified 11 flows operated by its 'megabus' coach services which overlap with SWF services. In each case it has identified a National Express coach service which it claims competes on the flow.
27. Stagecoach launched megabus coach services in 2003, undergoing significant expansion in 2004, when the overlaps with the rail services on the SWT commenced. Therefore, when Stagecoach launched the megabus services it already operated the rail services on the overlap flows in question. In the OFT's view, this might suggest that Stagecoach does not consider that the coach and rail services on these flows compete for the same passengers or, if they do compete, to inhibit entry by an alternative coach operator.
28. The theory of harm with respect to these overlapping flows is that, if the coach and rail services operated by Stagecoach on these flows are close substitutes, and if there are no other competitive constraints, awarding the franchise to Stagecoach (rather than an alternative TOC) would prevent a reduction in unregulated rail fares or in coach fares or an increase in the

¹⁰ Virgin Voyager is the bidding vehicle and has a similar ownership structure to VXC.

frequency of coach services, which would have occurred if the franchise was awarded to an alternative, non-overlap, TOC. The constraint provided by National Express was therefore important to the OFT's analysis.

29. The SWF services, the coach services of megabus and the coach services of National Express generally (but not always) operate from different terminals in the same town. Stagecoach provided overlap information on a settlement basis i.e. overlapping services were identified as those where the start and end points of the coach and rail services were within the same settlement. This criterion was also used to determine whether National Express was a competing operator on the flow.
30. The identification of overlapping public transport flows on a settlement basis has been used in previous CC cases¹¹ specifically for rural areas, as in urban areas the identification of point-to-point overlapping flows is generally more precise, reflecting the denser provision of public transport services. The OFT therefore considered whether the competing National Express services, as identified by Stagecoach, are indeed services operating on the same flows as the SWF rail and Stagecoach's megabus services¹².
31. A closer inspection of the stopping locations at the origin and destination of each service operated by National Express on the overlapping flows showed that in all 11 instances they are very close to the origin and destination locations of the respective megabus services, roughly equidistant to the rail station when compared to the megabus stopping places, or closer to the rail station than the respective megabus services. This suggests that the National Express services are either as close or closer competitors to the SWF rail services on the basis of start and end points. Given this, it was not necessary to conclude on the precise distance

¹¹ See for example the CC's decision in *FirstGroup plc and the Scottish Passenger Rail franchise* (June 2004).

¹² For example, even if the start and end point of all three services are within the same settlement, if the start and end points of Stagecoach's rail and Stagecoach megabus services are close to each other but the start and end points of the corresponding National Express services are not, such that passengers would not consider the National Express service to be a substitute to the corresponding Stagecoach coach services, then the National Express service may not be regarded as being on the same flow for the purpose of competition assessment.

between coach and rail stations for the purpose of identifying overlapping public transport flows.

32. National Express confirmed that the services it operates on the overlap flows are very frequent services, operated at up to fifteen times a day in each direction. National Express told the OFT that it does not believe that the coach services on these flows are directly competing with the rail services on the SWF, particularly insofar as the rail services cater for business and commuting passengers. However, the OFT considers that, even if coach and rail do compete for passengers on the overlap flows, the National Express services would be a strong competitive constraint on the respective SWF rail services and on the megabus services: on each of the 11 flows National Express runs at least one service which is at least twice as frequent as Stagecoach's megabus service.
33. Therefore, given that these coach-on-rail overlaps were created after Stagecoach acquired the SWT franchise, and the presence of National Express services on all the overlapping flows, we do not consider that if the SWF franchise was awarded to an alternative, non-overlap, TOC that there would be significantly more competition between coach and the services provided in respect of the SWF.

Bus-on-rail overlaps on point-to-point flows

Identification of point-to-point overlap flows

34. In order to identify overlapping flows, Stagecoach used the methodology employed by the CC in First / Great Western. In that investigation the CC treated bus stops and train stations as overlapping if they were located within 400m of each other in urban areas; for journeys with one end outside the particular urban area, a distance between bus stops and train stations of 1,200m was used at both ends. For flows in more rural areas bus stops and rail stations were treated as having the same start and end point where they serve the same settlement. On this basis, Stagecoach identified a total of 150 overlap flows (encompassing 48 routes).
35. In previous rail franchise enquires, most recently in First / Great Western, the CC has also adopted a series of 'filters' designed to identify a subset of overlaps that may raise competition problems. The OFT has previously acknowledged the utility of filters at first-phase merger review where

sifting the number of flows to be considered to a manageable number is necessary, while noting that such filters are pragmatic, need to be checked for robustness/sensitivity, and could be case-specific (see FirstGroup/ICEC Commentary¹³). Following discussions with the OFT as to the appropriate filters to use in order to reduce the analysis to a manageable level, Stagecoach applied the '10 per cent rule' to the overlap flows. This filter has been used consistently by the CC in its rail franchise investigations, including First / Great Western, on the basis that there are likely to be limits to which fares could be increased or services reduced on one flow without affecting other flows on the same route and putting at risk the revenue from them¹⁴.

36. The application of the 10 per cent filter left 14 routes for our analysis. These routes (consisting of a total of 64 flows) are operated by two different Stagecoach regional bus operating companies: Stagecoach South and Stagecoach South West. The routes/flows operated by each of these companies is considered separately in our competitive analysis.

Theory of harm

37. As discussed above, the position of Stagecoach as the incumbent operator of the two franchises comprising the SWF requires a unique consideration of the theory of harm. The OFT must consider whether the award of the SWF franchise to Stagecoach is preventing the introduction of competition on those overlapping flows, which would occur if the franchise was awarded to a different TOC.
38. In the context of the bus-on-rail overlaps, this required us to consider whether, if the SWF was awarded to a TOC raising no competition concerns, there would be greater competition between bus and rail overlaps. This is based on the assumption that the overlapping bus and rail services are substitutable modes of transport such that Stagecoach (being the operator of both modes of transport) is significantly stifling competition that otherwise would take place between them. The theory of harm in relation to bus services is that the award of the SWF to Stagecoach would

¹³ CC's *FirstGroup/ICEC merger inquiry: commentary on issues statement* (June 2005).

¹⁴ The 10 per cent rule considers that the routes which are most likely to give rise to concern are those routes where the percentage of revenues accounted for by all overlap flows on that route exceed 10 per cent of total route revenue. For a further description of this filter, as well as other filters used by the CC and OFT, see First / Great Western, Appendix E.

prevent a reduction in bus fares or an increase in bus service levels on overlapping bus-on-rail flows.

39. In relation to rail services, the potential theory of harm is that awarding the SWF to Stagecoach would prevent a significant reduction in unregulated rail fares on overlapping bus-on-rail flows. However, this theory of harm is tempered by the lack of an incentive for Stagecoach to raise unregulated rail fares when it first acquired the two franchises that form the SWF (and so encourage passengers on to its bus services), as this would result in lost revenue (as bus fares are generally cheaper than rail fares) and more costs if this strategy led to increased bus services without a corresponding increase in fares.¹⁵

Competitive analysis: Stagecoach South West

40. Following the application of the 10 per cent filter, there were 12 bus routes operated by Stagecoach South West that required further considerations. These 12 bus routes operate a total of 42 overlapping flows.
41. On 36 of these 42 flows Stagecoach submitted that it faced competition from FGW, who operate more frequent rail services than those that operate on the SWF, rendering FGW the lead operator on these flows. The OFT does not believe that Stagecoach is likely to have had an incentive to increase bus fares or reduce bus services on these flows during the term of the previous franchises, as this would have caused passengers to also divert to the FGW services, and since these services are more frequent than the respective Stagecoach services on the flow, such a strategy is likely to benefit FGW more than Stagecoach. A similar result would occur if Stagecoach had attempted any increase in unregulated rail fares.
42. On two further flows, the rail service operates much less frequently than the respective bus service (2 trains operating in each direction on a week day compared to 14 bus services in each direction). In addition, a frequent FGW rail service (relative to the Stagecoach rail service) operates on these flows, albeit that at one end of the flow the FGW service operated from a

¹⁵ It should be noted that rail costs are relatively fixed given the service level commitment. The service level commitment also prevents the rail theory of harm consisting of a service element, as is included in relation to buses.

station located 1.3km from the Stagecoach rail service. Therefore, we did not consider that there would be significantly more competition between the rail and bus services on these flows if the SWF was awarded to a different TOC.

43. On three of the remaining four flows all of the bus services operated by Stagecoach are tendered by the relevant local County Council, and any changes to the bus services or fares requires council approval. It follows that Stagecoach could not have increased fares/ reduced service levels on the bus services of these flows in order to divert passengers onto its rail services during its control of the SWF. Stagecoach may have increased unregulated rail fares on these flows; however, as discussed above, it is much less likely that such a strategy would have been profitable on its own. Therefore, we also believe it is unlikely that awarding the SWF to a different TOC would result in significantly lower unregulated rail fares on these flows.
44. On the final flow, Stagecoach operates four different services. One of the bus services operated by Stagecoach is tendered by the relevant County Council, while the other three are commercial. The overlap flow accounts for less than 10 per cent of the total revenue of each of these commercial services, such that, if it was not for the revenue generated by the tendered service on this flow (which accounts for approximately 13 per cent of the revenue generated on the entire *tendered* route) this flow and commercial routes would have been filtered out. We do not consider it likely therefore that Stagecoach would have had the incentive to make any changes on these services (on either frequency levels or fares) during its control of the SWF. Therefore, we also do not consider that there would be significantly more competition between the rail and bus services on this flow if the SWF was awarded to a different TOC.
45. Given the above analysis, we do not consider that if the SWF franchise was awarded to different TOC that there would be significantly more competition between Stagecoach South West bus services and the services provided in respect of the SWF.

Competitive analysis: Stagecoach South

46. Following the application of the 10 per cent filter, there were 2 bus routes operated by Stagecoach South that required further considerations. These bus routes operate a total of 22 overlapping flows.
47. Stagecoach does not face effective competition from a third party operated bus or rail service on any of these flows. Further, we were also unable to eliminate any of these flows from consideration on the basis of the services being tendered; although Stagecoach submits that on a number of these overlapping flows it runs a partially tendered service – weekend and evening services are tendered – on all of the 22 overlapping flows it is able to set fares and service levels on a commercial basis on weekdays.
48. We therefore considered whether the modes of transport on the flows were sufficiently substitutable such that the award of the SWF to another TOC would stimulate competition on the flows. Stagecoach submitted that the bus and rail services were not close substitutes. On over half of the flows the bus journey time was over double that of the rail service (and on six of these the bus journey time was three times that of the rail service). Some other flows had very few or no passengers using the bus service. Finally, Stagecoach submitted that on all of the flows passengers were unlikely to view the bus and rail services as substitutes due to a number of factors, primarily that due to the 'settlement' nature of the analysis, revenue from bus passengers travelling in the relevant towns, a long way from the station, but near to a bus stop, have been included in the analysis of these flows.
49. Given the generalised cost nature of the market definition analysis, the OFT will not typically consider that evidence of different journey times, different embarkation and disembarkation points and/or different frequency of services will necessarily be sufficient to conclude that services are not substitutable. In this case we therefore considered two other sources of evidence regarding the substitutability of the modes of transport on the overlapping flows: a customer survey; and evidence of price rises since the initial acquisition of the South West trains and Island Line franchises.
50. Because Stagecoach was unable to supply empirical evidence to support their claims that the bus and rail services on the overlapping flows were not substitutable, the OFT invited Stagecoach to carry out a customer

survey on the overlapping flows in order to support their submission. Based on the theories of harm, we requested that the customer survey should cover both rail passengers (to obtain an estimate of the proportion of rail passengers that are likely to switch to bus if bus services became relatively cheaper/more frequent) and bus passengers (to obtain an estimate of the proportion of bus passengers that are likely to switch to rail if rail services become relatively cheaper). The methodology of the survey was agreed with the OFT to ensure that this was achieved.

51. The results of the survey suggested that rates of switching between rail and bus services were very modest, even in the event of a 5 – 10 per cent change in fare levels. For rail users in particular, the survey suggested that the bus service was not a serious alternative for a significant number of people, many having very little knowledge of available bus services. The results of the survey showed that, on average across the overlapping flows, if the price of bus journeys were to fall by 10 per cent, 15 per cent of rail users would seriously consider switching to bus; and if the price of rail journeys were to fall by 10 per cent, 16 per cent of bus users would seriously consider switching to rail. We considered these rates of switching to be very modest and not sufficient to raise the incentives of a standalone bus company or rail company to reduce prices or raise frequencies.
52. In addition to the survey evidence, the OFT also considered the development of the overlapping services since the initial acquisition by Stagecoach of the SWT franchise, which was cleared by the OFT in 1996¹⁶. In particular, we looked for evidence of price and service changes on the overlapping flows since the initial acquisition of the SWT franchise. Price increases or service changes particular to the overlapping flows would have suggested that Stagecoach was seeking to exploit any decrease in competition on the routes as a result of its initial acquisition of the SWT franchise.
53. As set out above, the overlapping flows in relation to Stagecoach South comprise two routes. On route 76/86 two services operate. While the 86 services was introduced following the award of the SWT franchise,

¹⁶ While the initial acquisition of the South West Trains franchise by Stagecoach was cleared by the OFT (decision of 15 February 1996) the OFT believes that this alone is not sufficient evidence, in light of changes to the regulation of mergers and the provision of bus and rail services (both generally and within the franchise area) to dismiss potential competitive concerns in this case.

Stagecoach submitted that the introduction of this extra bus service did not alter the frequency of bus services operating on the route as a whole, as Stagecoach decreased the frequency of the other 76 service upon the introduction of the 86 service. Overall, Stagecoach submits that the frequency of services has remained roughly unchanged on most of the route since the original acquisition, with the exception of a slight frequency reduction on one segment of the route. In respect of the 70/71/92 route, Stagecoach submits that services on the route were also operating broadly to their current timetable and service pattern when the South West franchise was first acquired.

54. With respect to fares, Stagecoach submits that any fare changes on the two routes were equivalent to fare changes across the whole Stagecoach South division and that in each case fares were increased to reflect an increase in costs. We have no evidence to suggest that the Stagecoach information is incorrect in respect of these routes, and no third party expressed the view that Stagecoach had increased fares or reduced service levels significantly on the overlapping bus and rail services since it acquired the South West trains franchise.
55. Overall, on the basis of the evidence available, we do not consider that there would be significantly more competition between rail and bus services on these 22 overlapping flows if the SWF was awarded to an alternative TOC.

Network effects

56. As discussed above, a consideration of network markets is important where an operator provides both rail and bus services as part of a broader public transport network. In this case, Stagecoach's bus operations may be complementary to rail services provided by the SWF, e.g. where bus services are used to travel to railway stations for onward journey by rail.
57. We considered the possibility that the merger could result in adverse effects on network competition between bus operators by enabling Stagecoach to leverage its position as a rail operator to weaken any competition to its bus services, e.g. by offering combined bus and rail tickets restricted to its own services, or restricting information on bus services at rail stations to its own services. In effect, however, because Stagecoach is the incumbent operator of the SWT franchise, the relevant

question we need to answer is if it has leveraged its position as a rail operator to weaken competition to its bus services during this time and if so, whether this is likely to continue if SWF is awarded to it a second time.

58. Stagecoach told us that the multi-modal schemes it participates in are managed by a TOC or by the Association of Train Operating Companies (ATOC) and that it does not have any input into the rules of such scheme. It also submits that it is not currently active in any exclusive multi-modal ticketing schemes. However, upon appointment as the franchisee of the SWF Stagecoach would be in a position to manage a number of schemes in which it will be the only participating bus operator. In about half of the schemes in which it does operate it is the only bus operator participating in the scheme.
59. Stagecoach maintains that despite this it has very little incentive to inhibit access by other operators to multi-modal schemes. It submits that across its bus network very low revenues were earned from sales of multimodal tickets: total receipts for the financial year 2005/06 are commonly measured in hundreds of thousands of pounds, with bus receipts forming an even smaller proportion of these revenues. It also maintains that the franchise agreement itself requires the acquiring TOC to promote multi-modal integration of transport.
60. In First / Great Western the CC found that the franchise agreement contained a number of measures to promote multi-modal integration of transport, including maintaining the appointment of a dedicated transport manager, promotion of integrated tickets and integrated services, establishing integrated partnerships with local authorities and transport operators, continuing existing multi-modal arrangements, and liaising with bus operators and other TOCs¹⁷. Similar obligations are contained in the SWF franchise agreement, and the DfT confirmed with us that these obligations are similar in nature to that of the First / Great Western franchise agreement. In addition, we received no third party concerns regarding access to multi-modal arrangements.
61. Given the above analysis, the OFT does not consider this acquisition to adversely affect network competition.

¹⁷ See paragraph 5.111.

VERTICAL ISSUES

62. No vertical issues arise with this merger.

THIRD PARTY VIEWS

63. We received very little in the way of substantive responses from third parties. Despite explaining the unique nature of the counterfactual in our questions to third parties, many suggested that the acquisition would not materially change competition in the area given Stagecoach was the incumbent operator. Most transport operators argued that they were constrained by private travel. A number of third parties also supported Stagecoach's submission that their rail and bus activities are conducted independently of one another. No third parties had concerns regarding the acquisition.

ASSESSMENT

64. Stagecoach's successful bid for the SWF gives rise to a number of overlaps within the franchise area. The overlaps involve rail-on-rail (with VXC), rail-on-coach (with megabus) and rail-on-bus (with Stagecoach's bus operations) services.
65. The OFT used the supply of passenger transport services on point-to-point routes as the relevant frame of reference, while also assessing the overall network effects of the acquisition. We considered these frames of reference against a counterfactual of the award of the SWF franchise either to a company that would raise no competition concerns or to one in respect of which any competition concerns would be remedied through behavioural remedies. Given that Stagecoach was the incumbent operator in this case, the theory of harm involved an assessment of whether the award of the SWF to Stagecoach would prevent the introduction of competition, and hence a reduction in bus, coach, and/or unregulated rail fares or an increase in services on the overlapping flows.
66. In respect of the rail-to-rail overlaps, given that the Cross Country franchise was due to expire on 11 November 2007 we found that it was not necessary to reach a conclusion on either the competition between VXC and SWF or the constraint provided by FGW on the overlap flows. The OFT

will have the opportunity to assess the competitive situation on these flows if Virgin Voyager is selected as the new franchisee for this franchise.

67. The coach-on-rail overlaps were created after Stagecoach originally acquired the SWT franchise, and National Express operates coach services on each of the overlapping flows. These National Express services are more frequent than the corresponding Stagecoach megabus coach services and in a number of the overlapping flows the start and end point of the National Express service are closer to the rail stations than the corresponding megabus services. Therefore, we do not expect that there would be significantly more competition between coach and rail services on these overlaps if the franchise was awarded to a different TOC.
68. In respect of the bus-on-rail overlaps, the theories of harm rested on two assumptions; first that the overlapping services in question are close substitutes from the perspective of passengers and second that, recognising this, Stagecoach increased prices / reduced service frequency on these services when it first acquired the SWT franchise ten years ago. In relation to Stagecoach South West services, we found that Stagecoach was already constrained by a combination of tenders and rail competition such that we do not consider that there would be significantly more competition between the rail and bus services on this flow if the SWF was awarded to a different TOC.
69. In relation to Stagecoach South bus services, we found no evidence that Stagecoach did increase bus or unregulated rail fares above competitive levels, or reduced service frequencies below competitive levels, following its original acquisition of the SWT franchise. We also found that the bus and rail services in question have different characteristics and the evidence from the consumer survey supported the view that they are not close substitutes. Therefore, as compared to the counterfactual, we do not expect that a standalone bus and rail company would have an increased incentive to significantly lower fares or increase frequencies on these flows.
70. Finally, we considered the effect on network competition from the award of the franchise to Stagecoach. We found that Stagecoach obtained very little revenue from sales of multi-modal tickets in the franchise area. In addition, we found that the SWF franchise agreement contained sufficient measures to promote multi-modal integration of transport, such that

Stagecoach would not be able leverage its position as a rail operator to weaken any competition to its bus services.

71. Consequently, the OFT does not believe that it is or may be the case that the merger has resulted or may be expected to result in a substantial lessening of competition within a market or markets in the United Kingdom.

DECISION

72. This merger will therefore not be referred to the Competition Commission under section 22(1) of the Act.