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## Competition Act 1998

Decision of the Office of Fair Trading  
No. CA98/05/2004

First Edinburgh / Lothian

29 April 2004  
(Case CP/0361-01)

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### SUMMARY

The OFT has concluded that in reducing its fares and increasing the scale of its commercial bus services in the Greater Edinburgh area over the period between March 2000 and July 2002, First Edinburgh Limited (First Edinburgh) has not infringed the prohibition imposed by section 18 of the Competition Act 1998 (the Act).

The OFT's investigation was initiated by a complaint made by Lothian Buses plc (Lothian). Lothian alleged that First Edinburgh was abusing a dominant position in a market for commercial bus services by pricing at predatory levels and by increasing the number and frequency of services within the Greater Edinburgh area. Lothian also suggested that First Edinburgh was using the profits it gained from its operations in the area surrounding Edinburgh to subsidise its expansion within Edinburgh.

The relevant product market in this case is likely to be commercial bus services. The OFT did not reach a final conclusion on the precise boundaries of the appropriate geographic market. However, the investigation suggests that two or more markets are relevant in this case:

- a market that can be approximately identified as the Greater Edinburgh area; and
- one or more market(s) in the area surrounding Edinburgh.

Within the Greater Edinburgh area (in which the alleged predation took place) Lothian is by far the bigger operator, and it appears likely that Lothian, rather than First Edinburgh,

is the dominant operator in Greater Edinburgh. In contrast, First Edinburgh accounts for a high proportion of journeys in the area surrounding Edinburgh, and it appears likely that First Edinburgh has a dominant position in a market (or more than one markets) in the area surrounding Edinburgh.

The OFT has concluded that it was not abusive for First Edinburgh to reduce its fares and increase the number and frequency of its services within Greater Edinburgh to the levels that it did over the period of time in question. Despite finding that First Edinburgh was likely to be pricing below average variable cost on some routes some of the time, the balance of the evidence indicates that the period witnessed intense competition between the two companies rather than an attempt by First Edinburgh to drive Lothian from the market. The OFT found evidence that First Edinburgh did not intend to drive Lothian out of the market and that it did not believe it was capable of doing so. Instead, the evidence indicated that First Edinburgh was incurring short-term losses in an attempt to establish a more secure commercial basis for its Edinburgh operations.

The OFT has therefore decided that, whether or not First Edinburgh is dominant in any relevant market, in behaving as it did in the Greater Edinburgh area over the period of time in question, First Edinburgh has not infringed the prohibition imposed by section 18 of the Act.

*Note: Certain information has been redacted from this document to comply with the requirements of section 244(3) of the Enterprise Act 2002 regarding disclosure of information. Redactions are denoted by [...] or, where possible, by replacement of the information concerned with either an approximate indication of the redacted figure or similar information that is in the public domain, indicated in italics within square brackets.*

## **I THE FACTS**

### **A The complaint**

1. In March 2001, the OFT received a complaint from Lothian, an operator of public transport services in Edinburgh, East Lothian and Mid-Lothian, about the conduct of First Edinburgh, a subsidiary of FirstGroup plc (FirstGroup), a multinational operator of public transport services with extensive interests in bus and coach operations throughout the UK.
2. Lothian has alleged that First Edinburgh had engaged in anti-competitive practices in the Greater Edinburgh area during the period between 27 March 2000 and mid-July 2002. Annexe 1 contains a brief description of the main changes to the activities of First Edinburgh and Lothian in Edinburgh between March 2000 and July 2002.
3. The OFT has therefore conducted an investigation into allegations that:
  - First Edinburgh engaged in a strategy of predatory pricing by introducing services on a number of routes within Edinburgh to compete against those of Lothian, and subsequently reducing fares on its existing and new services within Edinburgh; and
  - First Edinburgh used profits gained in the areas surrounding Edinburgh, where it did not face significant competition, to subsidise expansion in Edinburgh, where it faced competition from Lothian.

### **B The parties**

#### **LOTHIAN**

4. Lothian is the largest municipal bus operator in the United Kingdom. It operates 563 buses and 11 coaches on local bus service routes, schools contracts and private hire work.<sup>1</sup> The City of Edinburgh Council holds 91 per cent of the issued share capital of Lothian; the remaining shares are held by East Lothian Council (3.1 per cent), Mid Lothian Council (5.5 per cent) and West Lothian Council (0.4 per cent).<sup>2</sup> These shareholdings reflected the share of Lothian's operations in 1996, and the pattern of services was virtually identical in February 2004.

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<sup>1</sup> Source: *Bus Industry Monitor 2002*, TAS Publications and Events Ltd, 2002.

<sup>2</sup> Source: *Bus Industry Monitor 2002*, TAS Publications and Events Ltd, 2002.

Group turnover in the year to 31 December 2002 was £62.9m, operating profit £5.5m, profit before tax £5.3m. Gross assets less current liabilities for the group at 31 December 2002 totalled £43.8m (fixed assets £46.6m, current assets £10.8m, current liabilities £(13.6)m).<sup>3</sup>

## FIRSTGROUP

5. FirstGroup is a multinational operator of public transport services with extensive interests in bus and coach operations throughout the UK and, according to its annual report for 2000, was the UK's largest bus company. It runs bus services in Aberdeen, Glasgow, Edinburgh, the Borders, York, West and South Yorkshire, London, Berkshire, Buckinghamshire, Wiltshire, Norfolk, Suffolk, Hereford, Merseyside, Stoke-on-Trent, Manchester, rural Cheshire and Derbyshire, Leicester, Northampton, the West Midlands and Worcestershire, Essex, Portsmouth, Southampton, South and West Wales, Bristol, Dorset, Avon, Somerset, Devon and Cornwall. It also operates trams (the Croydon Tramlink) and railways.<sup>4</sup> In addition, it operates services in the United States (37 states). Total group turnover in the year to 31 March 2003 was £2,291m (principally, UK bus £859m, UK rail £842m, North America £582m), operating profit £216m, and pre-tax profit £160m. Total assets less current liabilities for the group at 31 March 2003 amounted to £1,158m (fixed assets £1,273m, current assets £456m, current liabilities £(572m)<sup>5</sup>).<sup>6</sup>
6. First Edinburgh is a subsidiary of FirstGroup. It operates [561] buses within the Greater Edinburgh area and Central and Borders region.<sup>7</sup> First Edinburgh operate

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<sup>3</sup> Source: Lothian Buses plc, Report and Accounts for the Year Ended 31 December 2002.

<sup>4</sup> During the period of the investigation FirstGroup operated three franchises: First Great Eastern (this franchise was awarded to National Express Group plc on 30 January 2004), First Great Western (due to expire in February 2006), and First North Western (this franchise expires in 2004 and the services covered by have been split between three new franchises - Northern Rail, TransPennine Express and Wales and Borders. An extension to the First North Western franchise has been signed which runs from 1 April 2004 until the commencement of the Northern Rail franchise, scheduled for October 2004. An agreement with First Group Keolis for the Transpennine Express franchise was signed in September 2003 and commenced on 1 February 2004. North Wales services were transferred to the Wales and Borders franchise in September 2003 and the new franchise, effective from 7 December 2003, was won by Arriva Trains). FirstGroup has also signed an agreement to operate Thames Trains which runs from 1 April 2004 to 31 March 2006.

<sup>5</sup> The £1m difference is due to rounding.

<sup>6</sup> Source: First Group Annual Report, 2003.

<sup>7</sup> [Source: *Bus Industry Monitor 2002*, TAS Publications and Events Ltd, 2002.]

[120 - 180] buses wholly or partly within the Greater Edinburgh area and [90-130] buses within West Lothian.<sup>8</sup>

7. Although services in Edinburgh and the surrounding area continue to be operated within the same company, since April 2000 First Edinburgh has made changes to the way in which the company has been managed which have had the effect of creating two separate but coordinated business units. Services in the City of Edinburgh area are operated by the Edinburgh unit and services in the surrounding area are operated by the Central and Borders unit. At a First Edinburgh Board Meeting of 14 September 2000 it was decided that separate boards for the two units should be created.<sup>9</sup> Since then, weekly performance indicator reports for each depot have been restructured to reflect the two units and the management boards of the two units have met separately. Since April 2001, each unit has had its own profit and loss account, although the units still share a balance sheet.
8. The two business units are served by different depots. The Central and Borders unit is served by eight depots. During the period of the investigation, the Edinburgh unit was served by four depots; Dalkeith, Musselburgh,<sup>10</sup> Livingston and Westfield. The Westfield depot closed in July 2002.

## **C The investigation**

9. The OFT commenced an investigation of First Edinburgh under section 25 of the Act on 25 September 2001. At this point, the OFT requested a range of information from First Edinburgh in order to assist its analysis of First Edinburgh's alleged dominance and of the alleged abuse. Subsequent requests for information were made on 11 February 2002, 12 August 2002 and 31 December 2002.
10. The requested information included: details of routes and fare structures; data on costs and revenues at a route level for a sample of routes; profit and loss accounts for each of the depots serving Edinburgh; management documents (such as business plans, marketing plans, budgets, notes of Board Meetings);

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<sup>8</sup> Source: submission from First Edinburgh attached to a letter from First Edinburgh to OFT dated 3 October 2001.

<sup>9</sup> Source: letter from First Edinburgh dated 4 March 2002.

<sup>10</sup> First Edinburgh also has a facility at North Berwick. This facility is an outstation of Musselburgh and its revenues and costs are included as part of Musselburgh's profit and loss accounts.

information on market shares; and details of the utilisation of vehicles and drivers and performance indicators by depot.

11. The OFT also requested information from Lothian. This included: details of routes and fares structures; data on costs and revenues at route level for routes in competition with services run by First Edinburgh; company accounts; details of frequencies; and details of peak vehicle requirements.

## II LEGAL AND ECONOMIC ASSESSMENT

### A Introduction

12. The Chapter II prohibition is set out in section 18(1) of the Act, which states that:

*'any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.'*

13. In order to establish that an infringement of the Chapter II prohibition has occurred the OFT must show that the undertaking<sup>11</sup> concerned:

- holds a dominant position in a relevant market; and
- has abused that dominant position; and that
- the abusive conduct may affect trade within the UK.

14. Under section 60 of the Act the OFT is required, in applying the Chapter II prohibition, to ensure that there is no inconsistency with either the principles laid down by the EC Treaty and the European Courts or any relevant decision of the European Courts. The OFT must also have regard to any relevant decision or statement of the European Commission.

### B The relevant market

15. As noted above, the first stage in the analysis of whether or not First Edinburgh has abused a dominant position is to identify the relevant market(s) within which it operates.

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<sup>11</sup> The European Court of Justice (ECJ) has stated that *'in the context of competition law, ... the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way it is financed'* (Case C-41/90, *Höfner & Elser v Macrotron* [1991] ECR I-1979, paragraph 21). First Edinburgh constitutes an undertaking for the purposes of the Act as it is engaged in the economic activity of providing commercial bus services. As First Edinburgh is a subsidiary of FirstGroup it appears likely that FirstGroup and First Edinburgh comprise a single undertaking for the purposes of the Act.

## THE PRODUCT MARKET

16. The relevant product market comprises all those products and/or services which are regarded as interchangeable or substitutable by the consumer by reason of the products' characteristics, their prices and their intended use.<sup>12</sup>
17. First Edinburgh and Lothian both operate commercial bus services within Greater Edinburgh and the area surrounding Edinburgh. The question in this case, with regard to product market definition, is whether the relevant market should be any wider than the provision of commercial bus services.<sup>13</sup> To this end, the OFT has considered the extent to which other forms of transport can be considered sufficiently close substitutes. Potential substitutes include the use of private motor cars and other forms of public transport.
18. The OFT does not consider that private motor cars represent a sufficiently close substitute for commercial bus services to be included in the market. Many bus passengers do not have access to cars or could not use a car for their particular journey, for example because of a lack of parking facilities at their destination. Although rising bus fares might cause some people to use cars instead, it would probably take time or a very large increase in fares before large numbers would switch.
19. This is consistent with the approach taken in previous cases. For example, the Monopolies and Mergers Commission (MMC)<sup>14</sup> stated that:

*'Cars compete with buses in the general sense that they provide alternative forms of transport. There are, however, major differences between them in respect of price and convenience, while for many bus users the option of using cars is not available. They do not compete to the extent necessary for them to be regarded as part of the same market. In particular, they are not sufficiently substitutable by bus users to provide an adequate curb on the prices of bus operators.'*<sup>15</sup>

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<sup>12</sup> Notice of the European Commission on the Definition of the Relevant Market for the purposes of Community Competition Law, OJ 1997 C372/5, [1998] 4 CMLR 177, paragraph 7.

<sup>13</sup> It is also possible that the product market should be widened to include tendered bus services. As it was not necessary for the OFT to reach a conclusion on market definition this issue has not been considered further.

<sup>14</sup> The MMC was replaced by the Competition Commission on 1 April 1999.

<sup>15</sup> *FirstBus plc and S B Holdings Limited*, Monopolies and Mergers Commission report (January 1997) Cmnd 3531, paragraph 2.38.



20. The OFT notes the introduction of Government policies with the aim of encouraging people to switch away from using their motor cars to using buses.<sup>16</sup> However, the OFT considers that the extent to which these have succeeded in encouraging such a switch, or can be expected to do so in the future, is unlikely to make cars and buses sufficiently close substitutes for the purpose of market definition in this case.
21. Taxis may be used as an alternative to bus travel by some passengers. However, the underlying costs of taxis mean that they can never compete fully with buses on price and are therefore only a limited substitute for buses for the purpose of market definition in this case.
22. Other forms of public transport, such as train services, may also constitute substitutes for commercial bus services within Greater Edinburgh and the surrounding area, although there is a limited overlap between the routes and stops of train and bus services. As it was not necessary for the OFT to reach a conclusion on market definition this issue has not been considered in detail.
23. As there appear to be no sufficiently close substitutes for commercial bus services in Edinburgh, the OFT's view is that the relevant product market in this case is likely to be the provision of commercial bus services.

#### THE GEOGRAPHIC MARKET

24. The relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products or services in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.<sup>17</sup>
25. On the demand side, passengers have a desired start and end point to their journeys and will only switch between routes in response to a change in fares where the services provided are sufficiently similar. Where passengers are not prepared to switch to other routes, demand-side considerations would point to a

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<sup>16</sup> The Transport Act 2000 and the Transport (Scotland) Act 2001 oblige local transport authorities to develop local transport plans, including a 'bus strategy'. These bus strategies are designed to improve the quality of bus services, for example through the use of Quality Partnerships and multi-operator ticketing schemes.

<sup>17</sup> Paragraph 8 of the Commission Notice on the Definition of the Relevant Market for the purposes of Community Competition Law, OJ 1997 C372/5, [1998] 4 CMLR 177. See also paragraphs 4.1 to 4.10, Market Definition (OFT 403).

geographic market definition limited to each individual route operated by a bus company.

26. Supply-side substitution may also be relevant to geographic market definition. If, in response to a price rise by incumbent firms, other firms which do not currently supply a product or service would supply that product or service at short notice, this may constrain the ability of incumbents to increase prices.<sup>18</sup> Looking at the supply side for commercial bus services, the geographic market may include all routes from which buses may be switched in response to a change in fares. This would indicate that a market may therefore be wider than an individual route, providing it is clear that substitution would occur relatively quickly and easily.
27. Buses that operate from the same depot can generally be switched between routes emanating from that depot. This suggests that all routes within the catchment area covered by a single depot might form part of the same geographic market. Where there is significant overlap between catchment areas, the geographic market may include the areas served by a number of depots.
28. In the case of First Edinburgh it appears that, subject to certain operational considerations, many services within the City of Edinburgh area could be switched between the Dalkeith, Musselburgh and Westfield depots. Factors that constrain such substitutability in principle include the need to be close to a depot at certain times for driver change over, or the need to operate a particular combination of routes from the same depot in order to make efficient use of vehicles and drivers. In practice, factors such as the availability of maintenance facilities also determine which depot a particular service is operated from.
29. First Edinburgh has depots at a number of small towns in the area immediately surrounding Edinburgh: Bannockburn, Larbert, Linlithgow, Deans, Peebles, Galashiels, Hawick, Kelso and Berwick upon Tweed. The OFT has not considered in detail the extent to which these are substitutable. It is possible therefore that the catchment areas of these depots may each form part of a number of separate markets or together be part of a wider market.
30. Given the OFT's finding on the allegedly abusive behaviour of First Edinburgh (see paragraphs 49 to 79), it was not necessary to reach a conclusion on the

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<sup>18</sup> Paragraph 3.13, Market Definition (OFT 403).

precise boundaries of the appropriate geographic market.<sup>19</sup> However, the investigation suggests that two or more markets are relevant in this case:

- a market that can be approximately identified as the Greater Edinburgh area; and
- one or more market(s) in the area surrounding Edinburgh.

## **C Dominance**

31. The European Court of Justice (ECJ) has defined a dominant position as:

*'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by allowing it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of consumers.'*<sup>20</sup>

32. In assessing dominance the OFT considers whether and to what extent an undertaking faces constraints on its ability to behave independently. Those constraints might, for example, be existing or potential competitors, or other constraints such as buyer power.

### **FIRST EDINBURGH'S POSITION ON THE MARKETS**

33. Market shares, although not conclusive, provide some insight into the level of actual competition in a market. In this case, as the boundaries of the market have not been precisely defined, it is not possible to provide data on 'market' shares. Instead, the OFT has compiled data on shares of activity, based on registered mileage and turnover, for two areas which provide an approximation of the relevant markets.
34. The first region is an approximation of the Greater Edinburgh area. This has been labelled the Greater Edinburgh Competitive Area (GECA) and is the area in which Lothian operates in competition with First. The second region represents the one or more markets in the area surrounding Edinburgh. This has been labelled the 'Surrounding Area' and is made up of the area bounded by First's depots at Bannockburn, Larbert, Linlithgow, Deans, Peebles, Galashiels, Hawick, Kelso and

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<sup>19</sup> A more detailed consideration of the geographic market definition would also have included a consideration of the substitutability of depots owned by other operators including Lothian, which has four depots in the Greater Edinburgh area.

<sup>20</sup> Case 27/76, *United Brands v Commission* [1978] ECR 207; [1978] 1 CMLR 429.

Berwick upon Tweed.<sup>21</sup> A map showing the locations of these depots and the boundaries of these areas is provided in Annexe 2.

35. Table 1 below provides details of the shares of activity of First Edinburgh and Lothian in the areas identified above. There are over 60 other operators who provide services in these areas. Data on shares of activity is not provided for these operators as they are all either small (with a turnover of less than £2m) or have a relatively small proportion (less than 15 percent) of their operations within this area.

Table 1

	Share of activity based on:			
	Registered mileage		Estimated turnover	
	First	Lothian	First	Lothian
GECA	[ < 20%]	[ > 70%]	[ < 20%]	[ > 70%]
Surrounding Area	[ > 70%]	[ < 20%]	n/a	n/a

Source: First Edinburgh response of 31 October 2001 to OFT Section 26 Notice dated 25 September 2001

36. Under both measures used, it is clear that Lothian has the greater share of activity in the GECA, where the alleged abuse took place. First Edinburgh, on the other hand, has a much larger share of the Surrounding Area, but a much smaller share of the GECA. Although, as is discussed above, there may be one or more markets in the area surrounding Edinburgh, OFT considers that the data presented in the table above reflects the underlying position of First Edinburgh in this area. In particular, as noted above, there are no large competitors in the region surrounding Edinburgh that might account for a large share within a particular area.
37. The OFT considers it unlikely that an undertaking will be individually dominant if it has a market share of below 40 per cent,<sup>22</sup> especially where a competitor in that market has a larger market share. Therefore, on the basis of the shares of activity of Lothian and First Edinburgh presented above, it appears highly unlikely that First Edinburgh is dominant in the provision of commercial bus services in

<sup>21</sup> The 'GECA' and 'Surrounding Area' were identified during the investigation for the purposes of requesting information before the boundaries of the relevant market could be established. Given the OFT's conclusions on abuse it was not necessary to determine the precise market definition or to obtain further information relating to these markets.

<sup>22</sup> See paragraph 3.13, The Chapter II Prohibition (OFT 402).

the Greater Edinburgh area. Instead these shares of activity suggest that First Edinburgh may be dominant in one or more markets in the area surrounding Edinburgh and that Lothian may be dominant in the Greater Edinburgh area.

38. It should be noted that the OFT considers that there are other factors, besides market share, which point to Lothian being the stronger operator within the Greater Edinburgh area. In particular, it has the more extensive network within the Greater Edinburgh area, which allows it to offer an attractive single operator travelcard and, during the period of the investigation, there was either no multioperator travelcard scheme in Edinburgh or the scheme had little success in attracting passengers.<sup>23</sup>
39. In considering whether First Edinburgh does hold a dominant position in one or more markets in the area surrounding Edinburgh, the OFT would also have to consider the extent to which *potential* competition is likely to constrain First Edinburgh's behaviour. Factors that might influence the likelihood of entry into these markets include the lack of nearby depots owned by other operators, the financial strength of First Edinburgh (through FirstGroup) and the impact that any predatory attack might have on its reputation for responding strongly to competition.
40. It is also relevant to consider the position of FirstGroup more generally in southeast Scotland. In June 1996, FirstGroup acquired 100 per cent of the issued share capital of S B Holdings Limited ('SBH').<sup>24</sup> SBH had a fleet of 1,200 buses operating mainly in Glasgow and the outlying towns to the north and east of the Glasgow conurbation. Although the merger was approved, it was made subject to undertakings.<sup>25</sup> Overall FirstGroup operates in the following local authority areas within southeast Scotland: Scottish Borders, West Lothian, Clackmananshire, Falkirk, Stirling, City of Glasgow, East Dunbartonshire and West Dunbartonshire.

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<sup>23</sup> A multi-operator ticket was launched in May 2001 by SESTRAN, a partnership of nine local authorities. In the first year very few tickets were sold (the total value of sales between May 2001 and March 2002 was just £[554]), mainly because they were priced at a significant premium over single operator tickets. Since May 2002 sales have increased substantially, and the total value of tickets sold between April 2002 and March 2003 was £[152,124]. (Source: *Final Report on Introduction of the SESTRAN Travelticket 01.04.1999 – 31.03.2003*, David Scotney Transport Planning Consultant, July 2003).

<sup>24</sup> *FirstBus plc and S B Holdings Limited*, Monopolies and Mergers Commission report (January 1997) Cmnd 3531.

<sup>25</sup> Amongst other things, the terms of the undertakings provided for a fare freeze for two years from 1 February 1998 within the Midland Bluebird and Lowland operating area (principally in the whole of Central and South East Scotland excluding the city of Edinburgh), with subsequent increases in fares limited to the change in the retail price index for the preceding year.

41. Given the OFT's conclusions on abuse, it is not necessary to reach a firm conclusion on dominance, and indeed this is not possible given that the precise boundaries of the market have not been defined. However, taking all of the factors identified above into account, the OFT considers that it appears likely that First Edinburgh holds a dominant position in one or more markets in the area surrounding Edinburgh, however those markets may be defined. The OFT also considers it highly unlikely that First Edinburgh was dominant in the Greater Edinburgh market, however that market may be defined. In this market, although no final conclusion has been reached, it appears likely that Lothian holds a dominant position.

## ASSOCIATED MARKETS

42. It is well established that, in certain circumstances, an undertaking with a dominant position on one market may abuse that position by engaging in abusive conduct on a neighbouring or associated market on which it is not dominant.<sup>26</sup> In *Tetra Pak II* the ECJ held that there could be abuse '*where conduct on a market distinct from the dominated market produces effects on that distinct market*' but only where this can be justified by '*special circumstances*'.<sup>27</sup> In this case the ECJ found that:

*'the quasi-monopoly enjoyed by Tetra Pak on the aseptic market and its leading position on the distinct, though closely associated, non-aseptic markets placed it in a situation comparable to that of holding a dominant position on the markets in question as a whole.'*<sup>28</sup>

43. The associative links between the markets identified in *Tetra Pak II* included: the fact that customers in one market were potential customers in the other; that Tetra Pak and its most important rival were present in all markets; that Tetra Pak's almost complete domination of the aseptic market gave it a favoured status on the non-aseptic market; and that its position on the aseptic market enabled it to concentrate its efforts on the non-aseptic market by acting independently of the other operators. The OFT does not consider that the associative links need to be as strong as was found in *Tetra Pak* in order for a

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<sup>26</sup> Case C-333/94 P, *Tetra Pak International SA v Commission* [1996] ECR I-595. See also Case C-62/86, *AKZO Chemie BV v Commission* [1993] 5 CMLR 215 and Case T65/89 *BPB Industries and British Gypsum v Commission* [1993] 5 CMLR 32.

<sup>27</sup> Case C-333/94 P, *Tetra Pak International SA v Commission* [1996] ECR I-595, paragraph 27.

<sup>28</sup> Case C-333/94 P, *Tetra Pak International SA v Commission* [1996] ECR I-595, paragraph 31.

firm with a dominant position in one market to abuse that position in another market.

44. The OFT has considered the possibility that First Edinburgh held a dominant position in one or more markets in the area surrounding Edinburgh and abused that position through its conduct on the Greater Edinburgh market. In assessing this possibility, the OFT considered whether associative links may exist between the Greater Edinburgh market and the market(s) in the area surrounding Edinburgh.
45. The fact that First Edinburgh has a high market share in the area surrounding Edinburgh may give it an advantage in attracting passengers who also wish to travel on connecting services within Greater Edinburgh, for example by allowing First Edinburgh to offer integrated services or tickets. Its high market share in the surrounding area may also provide First Edinburgh with advantages in supplying services within Greater Edinburgh, for example by allowing it to switch buses from depots serving outlying towns to depots serving Edinburgh or switching some routes to depots outside Edinburgh in order to free up additional capacity at its Edinburgh depots. In both respects, the fact that First Edinburgh faces limited competition in the area surrounding Edinburgh is likely to mean that it could focus its competitive strategies in the Greater Edinburgh area without a significant threat that any consequent reduction in its service levels in the area surrounding Edinburgh would be likely to stimulate a competitive response in the surrounding area that could threaten its position in that area.
46. A further potential associative link between the Greater Edinburgh market and the market(s) in the surrounding area is that they each provide the other with possible entrants. In particular, Lothian would appear to be the most obvious potential entrant in the area surrounding Edinburgh.
47. Another factor that may be relevant in this particular case is the impact of First Edinburgh's position in the surrounding area on the ability of First Edinburgh to deter further entry should Lothian be forced to exit the Greater Edinburgh market. The fact that there are no other large operators within the region surrounding Edinburgh suggests there is no ready supply of entrants that could easily establish significant operations in Edinburgh by expanding from an existing base. It would, of course, be possible in these circumstances for an entrant to purchase Lothian's assets as a means of entry, although such a purchase may be unattractive if First Edinburgh were to obtain a reputation for predatory behaviour.

48. The factors outlined above suggest that there may be associative links between the Greater Edinburgh market and the market(s) in the surrounding area. Given the OFT's conclusions on abuse, and the fact that no firm conclusion has been reached on the appropriate market definition, it has not been necessary to determine whether these associative links and First Edinburgh's position on the market(s) in the area surrounding Edinburgh are strong enough to outweigh the fact that Lothian has a very strong position in the Greater Edinburgh area and, therefore, to conclude that First Edinburgh holds the equivalent of a dominant position across the combined markets.

## **D Abuse of a dominant position**

49. The ECJ has defined the concept of an abuse as:

*'an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market, or the growth of that competition.'*<sup>29</sup>

50. In *AKZO*<sup>30</sup> the ECJ stated:

*'Article [82] prohibits a dominant undertaking from eliminating a competitor and thereby strengthening its position by using methods other than those which come within the scope of competition on the basis of quality. From that point of view, however, not all competition by means of price can be regarded as legitimate.'*

51. Lothian has alleged that First Edinburgh had abused a dominant position by:

- engaging in predation in the Greater Edinburgh area, by reducing prices (both on particular routes and for certain 'day' and 'weekly' tickets valid throughout Edinburgh), increasing frequencies on a number of routes and introducing a number of new routes; and

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<sup>29</sup> Case C85/76, *Hoffman-La Roche v Commission* [1979] ECR 461.

<sup>30</sup> Case C62/86, *AKZO Chemie BV v Commission* [1993] 5 CMLR 215.



- cross-subsidising this expansion in the Greater Edinburgh area, where it faced competition from Lothian, with profits from areas in which it held a dominant position.

Since concerns regarding any such cross-subsidisation relate to whether it facilitated the alleged predation, OFT has treated this as a second aspect of Lothian's allegation of predation rather than a separate category of abuse.

## PREDATORY PRICING

52. Predation infringes the Chapter II prohibition. It comprises strategic behaviour whereby a dominant undertaking deliberately incurs losses in order to eliminate a competitor, or deter market entry by potential competitors, so as to be able to charge excessive prices in the future.

53. In *AKZO*,<sup>31</sup> the ECJ established certain criteria to assess predation. Pricing between average total cost and average variable cost would be predatory if it forms part of a plan to eliminate a competitor.<sup>32</sup> Pricing below average variable cost should be presumed to be predatory, the ECJ stating that:

*'[p]rices below average variable costs ... by means of which a dominant undertaking seeks to eliminate a competitor must be regarded as abusive. A dominant undertaking has no interest in applying such prices except that of eliminating competitors so as to enable it subsequently to raise its prices by taking advantage of its monopolistic position, since each sale generates a loss.'*<sup>33</sup>

54. In *Tetra Pak II*,<sup>34</sup> the ECJ further states that:

*'prices below average variable costs must always be considered abusive. In such a case, there is no conceivable economic purpose other than the elimination of a competitor, since each item produced and sold entails a loss for the undertaking.'*<sup>35</sup>

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<sup>31</sup> Case C62/86, *AKZO Chemie BV v Commission* [1991] ECR I-3359, paragraphs 71-72.

<sup>32</sup> *Ibid*, paragraph 72.

<sup>33</sup> *Ibid*, paragraph 71.

<sup>34</sup> Case C-333/94 P, *Tetra Pak International SA v Commission* [1996] ECR I-5951, paragraphs 41-44.

<sup>35</sup> *Ibid*, paragraph 41.

In that case, the Court of First Instance (CFI) had found that the prices were considerably below average variable cost,<sup>36</sup> and therefore the ECJ found on appeal that: *'[p]roof of intention to eliminate competitors was therefore not necessary.'*<sup>37</sup>

55. Although the above quotes may suggest that a 'bright-line' cost test can be applied, the Competition Appeal Tribunal (CAT) judgment in *Aberdeen Journals* indicates that predation is an issue which must be looked at *'in the round'*, in particular taking account of whether the conduct has *'the effect of weakening or distorting competition in the relevant market.'*<sup>38</sup> The judgment notes:

*'Even where prices are below average variable costs, and despite the apparently peremptory wording of the judgments of the Court of Justice in AKZO, at paragraph 71 and Tetra Pak II, at paragraph 41, we do not exclude the possibility that, exceptionally, a dominant firm may be able to rebut the presumption of abuse.'*

*However, in our view the presumption of abuse will rarely, if ever, be rebutted if the pricing policy under scrutiny originates as an aggressive response to market entry by a competitor, or is directed towards eliminating a competitor.'*<sup>39</sup>

56. Therefore, although evidence of pricing below average variable cost provides a strong presumption of predation, an undertaking may be able exceptionally to rebut this presumption providing, *inter alia*, the pricing strategy is not directed towards eliminating a competitor.
57. As stated above (see paragraph 48), the OFT has not determined whether the associative links between the market or markets in the area surrounding Edinburgh and the Greater Edinburgh market, and First Edinburgh's position on these markets, are such that First Edinburgh can be considered to hold the equivalent of a dominant position on a combined Greater Edinburgh and surrounding area market. Nonetheless, given the possibility of First Edinburgh leveraging its dominant position in one or more markets in the area surrounding Edinburgh, First Edinburgh's conduct is assessed within this legal and economic framework in order to determine whether it can be said to have preyed in breach of the Chapter II prohibition.

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<sup>36</sup> Case T-83/91, *Tetra Pak II* [1994] ECR II-755, paragraph 150.

<sup>37</sup> Case C-333/94 P, *Tetra Pak International SA v Commission* [1996] ECR I-5951, paragraph 42.

<sup>38</sup> *Aberdeen Journals Limited v The Office of Fair Trading* [2003] CAT 11, paragraph 350.

<sup>39</sup> *Ibid*, paragraphs 357 to 358.

58. The OFT has examined data on First Edinburgh's costs and revenues, along with internal planning and strategy documents from the time of the alleged abuse. The OFT has also considered the financial situation of Lothian over the period in question. As is explained below, the OFT has found no evidence of a risk that Lothian would be forced out of the market by First Edinburgh's activities, nor has it found any evidence that this was First Edinburgh's intention in pursuing that course of action. On the contrary, the evidence supports First Edinburgh's contention that it was, as the smaller operator on the Greater Edinburgh market, responding to actions by a strong incumbent and trying to establish a more effective presence on that market.

#### ANALYSIS OF FIRST EDINBURGH'S ACTIVITIES

59. As noted above, the OFT has analysed First Edinburgh's costs and revenues and examined internal policy documents in order to assess First Edinburgh's intent. As the OFT's conclusions rely primarily on the use of First Edinburgh's internal documents and data on the position of Lothian in order to establish First Edinburgh's intent, only a brief summary of the analysis of cost and revenue data is presented below.

##### *Cost and revenue data*

60. Analysis of cost and revenue data has been conducted at the route, depot and company level. Each of these levels of analysis has certain weaknesses in this particular case:
- First Edinburgh's published accounts provide an overview of the financial situation over the period in question, but do not separate out the specific activities under investigation (i.e. bus services in Greater Edinburgh), or provide a detailed breakdown of costs;
  - Depot level data provide a more detailed breakdown of costs and revenues, but the depots used by First Edinburgh to service the Greater Edinburgh area (Musselburgh, Westfield, Livingston and Dalkeith) also run routes that serve the surrounding area. The OFT cannot therefore accurately determine by analysing depot profitability whether First Edinburgh was predating in the Greater Edinburgh area; and
  - Individual route analysis provides the most detailed information, but may be misleading because, for example, of the difficulty of allocating certain revenues (in particular from travelcard schemes) and common costs between

routes, and the existence of network effects (this is explained in more detail at paragraph 62 below).

Despite these individual weaknesses, together these different levels of analysis are helpful in providing an indication of the impact of First Edinburgh's price and service changes on its profitability.

61. The route level data analysed in this case was restricted to a sample of routes, given the large number of routes operated by First Edinburgh.<sup>40</sup> Cost and revenue information was analysed for 41 services<sup>41</sup> out of the 79 individual services operated by First Edinburgh that enter (or run solely within) the GECA.<sup>42</sup>
62. As noted above, revenue figures for an individual route may be misleading if analysed in isolation when considering a network industry, such as the provision of commercial bus services. This is because by providing a service on route A the operator of that service may be able to increase its revenues on other routes which connect with route A and are used by some passengers only because a service exists on route A. Any analysis of costs and revenues on route A in isolation might therefore provide a misleading picture of the true commercial position.
63. Taking account of all of the different issues highlighted above, the OFT's analysis of First Edinburgh's cost and revenue data suggests that there is strong evidence of First Edinburgh having set prices below its average total cost. There is also evidence that it was pricing below average variable cost on a significant number of the routes in the sample considered, and that these periods of very low pricing often persisted for many months. The extent of these losses varied over time and between routes, and the figures suggest that some of the various promotions and activities had differing effects on First Edinburgh's profitability.

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<sup>40</sup> The OFT originally requested that First Edinburgh supply completed cost and revenue questionnaires for all routes operated by First Edinburgh within the GECA. However, in view of the time and resources that would have been required to provide such detailed information for all routes, the OFT was prepared to modify its request and require, at least initially, data only for a sample of routes. In the light of the conclusions reached, it was not necessary to subsequently extend this request to all routes in this particular case.

<sup>41</sup> Some of these routes were operated from a combination of depots. In these cases separate data were provided for each depot which were then aggregated.

<sup>42</sup> This is the number of services (commercial, tendered and school) that were operated as at 7 November 2001. (Express versions of daytime commercial services are not treated as a separate service for this purpose). As noted above the GECA is an approximation of the Greater Edinburgh market which was used for the purposes of requesting information during the investigation.

64. Similarly, the analysis of First Edinburgh's annual reports indicates that First Edinburgh's income from its activities dropped significantly between 2000 and 2002. Turnover decreased from just over £42 million in 2000 to just over £37 million in 2002, a drop of just under £5 million or around 11.5 percent of the turnover in 2000. First Edinburgh's operating costs<sup>43</sup> also rose over the same period, from almost £38 million in 2000 to around £39 million in 2002, an increase of 3.9 percent. This led to a worsening of First Edinburgh's underlying profitability by over £6 million in just 2 years, from a profit of over £4 million in 2000 to a loss of over £2 million in 2002.<sup>44</sup>
65. However, analysis of the data at all levels also needs to take into account the impact of Lothian's actions on First Edinburgh's profitability. Lothian responded to First Edinburgh's increased activity and lower fares by increasing frequencies on some of its routes that were in direct competition with the First Edinburgh services.<sup>45</sup> To some extent, therefore, First Edinburgh's revenues may have been below costs as a result of Lothian's actions, rather than as the result of predatory intent.

#### *Internal documents*

66. In order for First Edinburgh's conduct (to the extent that it priced between average total cost and average variable cost) to be regarded as predatory, it is necessary to demonstrate that it formed part of a plan to eliminate a competitor. Equally, in order to rebut the presumption of predation resulting from First Edinburgh's practice of pricing below average variable cost on particular routes, it is necessary to show, *inter alia*, that its conduct was not directed towards eliminating a competitor.
67. The OFT examined a variety of internal documents from First Edinburgh that were produced at the time of the allegedly predatory behaviour. Analysis of these documents provides an insight into First Edinburgh's motivation behind its activities and into what outcomes it expected to see. The documents that the OFT considered included emails between members of First Edinburgh and FirstGroup management, internal strategy documents and reports produced by external consultants for First Edinburgh which considered the competitive situation in Edinburgh and the surrounding area.

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<sup>43</sup> These are the general operating costs referred to in First Edinburgh's annual reports.

<sup>44</sup> Data were also analysed for First Edinburgh's depots at Musselburgh, Westfield, Dalkeith and Livingstone. However, as noted above, it was not possible to draw any meaningful conclusions from this analysis as the routes operated from these depots include some serving the area surrounding Edinburgh as well as those serving the Greater Edinburgh area.

<sup>45</sup> These service changes are set out in the chronology of events provided in Annexe 1.

68. The OFT believes that the following points are demonstrated by the documents, when considered in the relevant market context:

- First Edinburgh **did** deliberately incur some short-term losses in the course of its activities in Greater Edinburgh, at least between August 2001 and January 2002, when the most extensive price promotions took place;
- these losses were incurred because First Edinburgh saw future benefits in establishing a more comprehensive network within the Greater Edinburgh area and in rationalising its depots serving that market; and
- at no stage did First Edinburgh intend to force Lothian from the Greater Edinburgh market, or believe that it was capable of so doing. Instead, First Edinburgh perceived itself to be at a significant disadvantage relative to Lothian in the Greater Edinburgh market, a view also held by its advisers.

69. A note of 10 July 2001, entitled '*Confidential. Battle Plan for Edinburgh. Expected Impact on Scotland Budget 2001/2*', clearly shows that First Edinburgh foresaw its strategy as being loss-making in the short term. The headline '*total budget adverse for Scotland 2001/2*' is (£[...]m), with revenue at risk from the competitive fares initiative calculated as (£[...]m) and revenue from new passengers generating only £[...]m.

70. However, none of the documents that the OFT has examined suggests that the aim of incurring these short-term losses was to force Lothian from the Greater Edinburgh market. Rather, they point to the strategy as being an attempt to improve on poor performance in the Greater Edinburgh area. For example, an email of 11 October 2000 from John Elliot-Jnr, First Glasgow's Marketing Manager, passes the following verdict on the First Edinburgh's services:

*'First Edinburgh operate four cross city services, three of which have a reasonably strong leg which is formed from a traditional First Edinburgh route extending through the city along traditional LRT sections of route, these city sections of route are not performing as well as they could. The fourth service is completely "city" and is performing very badly throughout. The services are operated by a mix of First Group double deckers and low floor darts and scania's.*

*The non Overground network is a typical mix of 60 and 30 minute services which travel in from First Edinburgh's traditional areas via city corridors. These routes are operated by a very mixed bag of vehicles and in most cases individual*

*routes are not even operated by one vehicle type. A lot of the vehicles are elderly and really don't compare with LRT's output on competing services. First Edinburgh appears to have fell behind in maintaining market share against LRT in these areas and in most cases the First Edinburgh service is timed behind the competing LRT service. There appears to be a great deal of scope to not only improve the competitive situation in these areas but also to [...] by [...]. Given that these services also operate through city corridors this would further enhance the "city" network as these services are currently viewed as "country" services and are not maximising their full potential within the city.'*

71. A later email from Mark Savelli, FirstGroup's Divisional Director (Scotland), to Mike Mitchell, Managing Director of FirstGroup's Rail Division, dated 21 June 2001, with the subject field 'Re[2]: Edinburgh Recovery Plans, attempts to 'explain the logic of our competitive strategy in Edinburgh'. This email discusses why various changes have been proposed to services and notes:

*'The trouble is that at present, given that we are in something of a crisis situation not having budgeted for these troubles, speed is regarded as being of the essence and a "quick fix" solution is being sought. Doing nothing is simply costing us too much, hence the need for urgent action.*

*The key to the success of the above strategy will therefore be in either*

- i) forcing Lothian to retreat on the routes on which we have seen recent service provision increases by suitably annoying them [...].*
- ii) or in our establishing a viable foothold in the Edinburgh City Market by means of a very competitive pricing strategy on [...].*

*In addition, a medium term action plan ([...]) would be [...], thus allowing the present [...] to be [...]. The P&L effect of this should be in the order of [...]. A critical handicap at the moment is that [...].'*

72. Also central to the OFT's findings was the evidence suggesting that First Edinburgh did not believe that it could force Lothian out of the Greater Edinburgh market. In an internal First Edinburgh note analysing Lothian's accounts for 2000/2001,<sup>46</sup> the following conclusions are presented:

- *'LRT is a robustly profitable company and its reported profits probably understate the true position compared to a commercial organisation.*

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<sup>46</sup> Attachment to email of 12 July 2001 from Alan Cockerham to Mark Savelli.

- *LRT has a very strong balance sheet with £11m of cash on its balance sheet at 31 March 2000. It is likely that this level of cash has been maintained.*
- *The company has access to HP/finance lease funding, although this was not used in 1999/2000, probably due to the large cash balances available.*
- *If profits declined sharply then the company could survive for a considerable period by avoiding capex and drawing on its cash reserves.'*

73. In addition, an external consultancy, TAS, prepared an analysis in late 2000 (presented to FirstGroup in January 2001) of the East and Midlothian Market (including Edinburgh) and discussed the position of Lothian. As well as describing Lothian as a formidable competitor, TAS said that

*'[Lothian's] public accounts show that they have substantial reserves providing them with a 'deep pocket' to sustain the current level of competition, possibly for an indefinite period. Lothian's shareholders have publicly declared that they are content with a much lower return than that required from First Edinburgh.'*<sup>47</sup>

74. There are also documents that indicate the extent to which First Edinburgh perceived itself to be in a weak position relative to Lothian within the Greater Edinburgh market. For example, in one email of 5 July 2001, Mark Savelli describes a bus journey within the city, where he passed 25 passengers waiting at bus stops, only one of whom got on the First Edinburgh bus. The driver noted that this was a typical experience and there was evidence that those who would not board the bus held Lothian day tickets. On a more general level, the email of 11 October 2000 from John Elliot Jnr quoted above provides the following description of Lothian:

*'In the Edinburgh and Mid/East Lothian areas LRT are the main competitor, not only operating a comprehensive network of city services but also extending out to serve on a frequent basis most significant areas in the Mid/East Lothian areas. They operate a very high quality fleet and are currently undertaking a period of heavy investment in new low floor double and single deckers. Publicity is excellent and the company also offers a range of value for money tickets, although significantly for First Edinburgh LRT treat the outer areas as part of "Greater Edinburgh" meaning that in most cases they are undercutting the equivalent First fare. A great deal of effort has obviously been done in getting the product right and if we do not get a grip on the situation now, there is a danger that LRT will do what Strathclyde Buses managed to do and extend from the city to actually replace First Edinburgh in its traditional area.'*

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<sup>47</sup> *East and Midlothian Market Assessment*, a report to FirstGroup plc prepared by the TAS Partnership Limited, page 25.



75. There is no evidence in this case that First Edinburgh's conduct was intended to drive Lothian out of the Greater Edinburgh area, nor that it believed that it was capable of doing so. Instead, the balance of evidence suggests that First Edinburgh's conduct was intended to establish a more secure commercial basis for its Edinburgh operations. As a result, the presumption of predation which arose as a result of its pricing below average variable cost can be rebutted, and its conduct of pricing between average total cost and average variable cost cannot be characterised as being predatory.

#### ANALYSIS OF THE POSITION OF LOTHIAN

76. One of the factors relevant to an assessment of whether a pricing practice by a dominant undertaking should be regarded as abusive for the purposes of the Chapter II prohibition is whether the effect of the practice is to weaken or distort competition.<sup>48</sup> As is discussed above (see paragraphs 72 to 73) the OFT considers that there is evidence to suggest that First Edinburgh considered Lothian to be financially strong and that it did not believe that it could force Lothian out of the Greater Edinburgh area. To supplement this evidence, the OFT has carried out its own analysis of the financial position of Lothian to examine whether it was at risk of being forced to leave the market or prevented from competing effectively by First Edinburgh's actions.
77. The OFT has used Lothian's publicly available Reports and Accounts to calculate Lothian's return on turnover (ROT) and return on capital employed (ROCE) to measure Lothian's profitability.<sup>49</sup> ROT is defined as operating profit before interest and tax as a proportion of turnover. ROCE is defined as operating profit before interest and tax divided by capital employed.<sup>50</sup> This data is presented in Table 2 below.

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<sup>48</sup> *Aberdeen Journals Limited v. The Office of Fair Trading* [2003] CAT 11, paragraph 369 *et seq.*

<sup>49</sup> ROCE is a more economically significant measure of profitability than ROT.

<sup>50</sup> Capital employed is defined as total assets (excluding cash and short-term deposits), less current liabilities (excluding dividends and corporation tax payable) and provisions (excluding provisions for deferred taxation). Cash and short-term deposits have been excluded because the amounts involved are greater than that needed to support the operating business.

Table 2

Year	Operating profits before interest and tax <sup>1</sup>	Return on turnover	Return on capital employed
1999	£4,837,000	9.79%	29.5%
2000	£5,193,000	9.98%	22.9%
2000 <sup>2</sup>	£5,940,000	13.65%	24.3%
2001	£5,074,000	8.95%	18.2%
2002	£6,159,000	10.05%	18.3%

<sup>1</sup> Exceptional restructuring costs of £2,711,000 for the nine months to 31 December 2000 and £2,961,000 for the twelve months to 31 March 2000 have not been deducted from operating profits because of the distortionary effect this would have on the measurement of Lothian's profitability.

<sup>2</sup> This row of data refers to the 9 months to 31 December 2000. All other data in the table relates to 12 month periods; for 1999 and 2000, these are the 12 months to 31 March and for 2001 and 2002, they are the 12 months to 31 December.

78. The OFT notes that Lothian's ROT dropped in 2001 from its trend level of around 10 per cent, but only to around 9 per cent, before returning in 2002 to around 10 per cent.<sup>51</sup> Lothian's ROCE has declined over the period being investigated, and whilst the OFT acknowledges that there can be difficulties in calculating economically meaningful ROCE data from published reports and accounts, it considers it highly unlikely from these ROCE figures that Lothian's profitability is below its likely cost of capital.<sup>52</sup>
79. In light of these factors, together with Lothian's high market share and substantial degree of market power on the Greater Edinburgh market, the OFT considers it unlikely that Lothian was at risk of elimination from that market as a result of First Edinburgh's conduct, or of damage that would prevent it from competing effectively in the future.

<sup>51</sup> The OFT also obtained from Lothian margin percentages, i.e. profit (or loss) divided by total revenue, for four-week periods between 25 March 2001 and 23 March 2002 in order to measure ROT over short periods. Lothian's ROT was, with the exception of two of the four-week accounting periods, always greater than [...]. It slipped to [...] for the four weeks ending 29 December 2001 and just below [...] for the four weeks ending 26 January 2002.

<sup>52</sup> As an example of the impact on Lothian's profitability, Lothian advised the OFT that it had, for the first time, bought second hand rather than new buses when undertaking fleet replacement because of the effect of First's actions. However, the OFT considers that the ROCE percentages in table 2 show that Lothian was making a satisfactory return on the total value of its capital employed.

### III CONCLUSIONS

80. First Edinburgh appears highly unlikely to be dominant in the Greater Edinburgh market in which the alleged predatory behaviour took place. It does, however, appear likely to be dominant in one or more markets in the area surrounding Edinburgh and there may be associative links between the Greater Edinburgh market and the market(s) in the surrounding area. However, Lothian has a larger market share, and appears to have a stronger position, than First Edinburgh in Greater Edinburgh. In the light of the OFT's conclusions on abuse, it has not been necessary to reach a final conclusion on whether First Edinburgh can be said to hold the equivalent of a dominant position across both markets.
81. The evidence obtained by the OFT indicates that First Edinburgh did price below average variable cost on some routes over some of the period in question. There is also evidence to suggest that First Edinburgh deliberately incurred some losses in the course of its activities (although the extent of those losses was determined to at least some extent by Lothian's activities on some of the routes in question).
82. Although evidence of pricing below average variable cost provides a strong presumption of predation, an undertaking may be able exceptionally to rebut this presumption providing, *inter alia*, the pricing strategy is not directed towards eliminating a competitor. In this case, the presumption of predation is rebutted as there is evidence that First Edinburgh did not intend to drive Lothian out of the Greater Edinburgh market with its actions, and that it did not believe that it was capable of so doing. The balance of evidence suggests that First Edinburgh was deliberately incurring losses in the short-run in an attempt to establish a more secure commercial basis for its Edinburgh operations and so compete more effectively with Lothian in that market in the longer term.
83. The OFT has therefore concluded that First Edinburgh's conduct, and Lothian's reaction to it, could be characterised as legitimate competition between rival undertakings, which ultimately benefited consumers within the Greater Edinburgh market by resulting, for a time, in lower fares and higher route frequencies, with no danger that this would lead to competition being weakened in the future.

**Justin Coombs**  
**Director, Service Industries**  
**Competition Enforcement Division**

**ANNEXE 1**  
**Chronology of events**

<b>Date</b>	<b>Significant activity by First Edinburgh</b>	<b>Significant activity by Lothian</b>
12 March 2000		<p>£1 maximum single fare to anywhere within Lothian's network introduced.</p> <p>Changes made to 39 services:</p> <ul style="list-style-type: none"> <li>• 12 services withdrawn, all of which were replaced (at least in part) by new services or an increase in frequency on other routes</li> <li>• three new services introduced, all of which replaced services that were withdrawn, and new weekend services introduced on three routes, one of which replaced a service that was withdrawn.</li> <li>• frequency reduced on two services, on one of which services were replaced by additional services on another route</li> <li>• frequency increased on seven routes</li> <li>• routes of 13 services changed</li> </ul>
27 March 2000	Price of City Explorer (renamed Day Explorer) reduced from £2.20 to £2.00. Off-peak City Explorer also renamed Day Explorer and area of validity extended to include the GECA and part of	

Date	Significant activity by First Edinburgh	Significant activity by Lothian
	the City of Edinburgh council area to the west of the GECA boundary.	
	70p fare within Edinburgh increased to 80p.	
1 May 2000	Off-peak maximum fare within Edinburgh of 70p introduced. Area of validity of off-peak Explorer ticket restricted to City of Edinburgh Council area.	
7 May 2000		Price of Adult Daysaver ticket increased from £1.40 to £1.50.
24 July 2000	'Edinburgh Overground' introduced. Provides high-frequency cross-city routes from mid and East Lothian, increasing the mileage operated on First Edinburgh services within the City.	

Date	Significant activity by First Edinburgh	Significant activity by Lothian
14 August 2000		Eleven services revised, with a reduction in frequency of two services, an increase in frequency for part of a Sunday service, the introduction of two new services, the withdrawal of one full service and one Sunday service and route changes for three services.
10 September 2000	Fares were increased by an average of 2.02% in the 'Lowland' area (to the west of Edinburgh) and 2.09% in the 'Midland' area (to the south and east of Edinburgh), as permitted by the Undertakings given following First's acquisition of SB Holdings.	
25 September 2000	A weekly ticket costing £7 valid for travel in an area slightly wider than the GECA introduced.	
4 December 2000		Service 87 extended to operate to Roslin.
15 January 2001		Service 20 introduced between Longstone and Stenhouse.
12 March 2001	Off peak maximum single fare increased from 70p to 80p within City of Edinburgh including Queensferry.	
23 April 2001	Service 88 introduced, existing service 79 amalgamated with service 43. Service 89 introduced, replacing existing services 74, 80,	

Date	Significant activity by First Edinburgh	Significant activity by Lothian
	80A and 129. Service 67 introduced, replacing services 55 and 129. Service C3 extended to Ocean Terminal.	
28 April 2001	Reduction in price of 4-weekly Livicards and Westcards which are partially valid in GECA.	
6 May 2001		Service 21 extended to operate to Gyle.
12 May 2001	Mid/East 4 weekly travelcards (valid across part of the GECA) reduced by £10.	
31 May 2001	Discount on Livicards and Westcards ended.	
4 June 2001	A 20p maximum fare introduced on the the Gyle to Edinburgh section of service 67. A weekly ticket costing £4 introduced on services 88/89 for travel between Gilmerton and Edinburgh City centre.	
14 June 2001	Discount on Mid/East travelcards ended.	
27 May 2001		Five services (18,80,81/X91,82,87) withdrawn, four of which are replaced in part by other services. Three new services introduced, the frequency of four services increased and frequency of two services decreased.
18 June 2001		Frequency of service 20 increased between Wester Hailes and Balgreen.

Date	Significant activity by First Edinburgh	Significant activity by Lothian
24 June 2001		Frequency of services 35 increased (Monday to Friday between Easter Road and Charlotte Square).
1 July 2001	Seven day ticket costing £4 extended to Gyle-Edinburgh section of service 67 and 20p fare offer on this section of this route withdrawn.	
13 August 2001	Offer on weekly ticket on services 88/89 between Gilmerton and Edinburgh City centre withdrawn. Offer on seven day ticket on Gyle-Edinburgh section of service 67 withdrawn. 'First Day' promotion, allowing all-day unlimited travel within GECA for £1, launched. Services 22, 23 and 44 introduced, routes or timetables for approximately fifteen services revised and a number of services (including 108, X08, C3, 66 and 99) withdrawn.	
16 August 2001	Edinburgh to Haddington day ticket introduced, priced £2.20 peak, £1.50 off peak. Two additional zonal tickets (CWE1 - £4.00, CWE1E2 - £5.50) which could be used for travel within GECA introduced.	
19 August 2001		Frequency of service 3/3A increased, frequency of service 29/29A reduced and the routes of five



Date	Significant activity by First Edinburgh	Significant activity by Lothian
14 October 2001		services revised.  Eighteen services revised, including reductions in the frequency of eight services, increases in the frequency of one service and the withdrawal of three complete and one Saturday services.
12 November 2001	Price of adult all day ticket increased from £1 to £1.50. Price of off peak day ticket increased from £1 to £1.20. Young person's ticket for CWW1 (which covers all of GECA) increased from 80p to £1.20. Service 11 introduced.	
19 November 2001	Price of CWE1E2 zonal ticket reduced from £5.50 to £4.50, in line with Scotland day ticket.	
2 December 2001		Frequency of three services increased, one service withdrawn and a new service introduced.
10 December 2001	Zone W1/CW (which includes GECA), adult day ticket increased from £2 to £2.50.	
6 January 2002	Service 25 withdrawn.	
7 January 2002	Service 87(which replaced service 25) introduced.	
14 January 2002	A £1 return fare introduced on four services (11, 22, 23 and 87). Young person's ticket	

Date	Significant activity by First Edinburgh	Significant activity by Lothian
	<p>withdrawn.</p> <p>Fares were increased by an average of 1.83% in the 'Lowland' area (to the west of Edinburgh) and 1.79% in the 'Midland' area (to the south and east of Edinburgh), as permitted by the Undertakings given following First's acquisition of SB Holdings.</p>	
27 January 2002		<p>Two services extended to operate to the Royal Infirmary, frequency of one service increased, one service revised and one new service introduced.</p>
8 April 2002	Services 23 and 87 withdrawn.	
14 April 2002		<p>Frequency of seven daily services and one Sunday service increased, and the route of two services revised.</p>
15 April 2002	Service 88 withdrawn and replaced with service 79.	
19 May 2002	Services 11 and 22 withdrawn.	
14 July 2002		<p>Routes of ten services changed. Increase in frequency of a daily evening service and one Saturday service re-introduced. Six night services withdrawn and replaced with new night services.</p>

## ANNEXE 2

### Map of the Greater Edinburgh Competitive Area, the Surrounding Area and First Edinburgh's Depots

