FIRSTGROUP/SB HOLDINGS REMEDY REVIEW

Summary of hearing with Lothian Buses on 10 December 2015

Introduction

1. Lothian Buses (Lothian) is the only remaining municipal operator in Scotland with almost 2,500 staff, 700 buses and one of the youngest fleets in the country. In 2014 Lothian carried over 118 million passengers and its unique structure allowed it to flourish in what had been challenging times for the local bus market.

2. Lothian said it had an independent arm's length board that set out strategic business plans. Its priority was not about maximising profits or shareholder value. It had a tacit understanding that it aimed to keep fares low, maintain network coverage and deliver a modest profit for the shareholder while still improving its environmental footprint, renewing assets, embracing technology and keeping up to date with any opportunities in the market.

3. Lothian told us that it was not actively encouraged to expand its boundaries. The City of Edinburgh was the 91% majority shareholder with minority shares held by East Lothian, Midlothian and West Lothian councils. The shareholders were not interested in Lothian expanding into Glasgow, Dundee or Aberdeen. The shareholders wanted Lothian to continue to deliver for the people of Edinburgh and its wider area.

4. Lothian told us that it tended not to take an aggressive outlook in terms of seeking to venture into new territories. It told us that after deregulation there were skirmishes that went on for 10 to 15 years. In 2001 FirstGroup tried to enter the market in Edinburgh very aggressively and Lothian defended its position. Since that time there were no major incursions or significant changes other than FirstGroup’s withdrawal from part of Midlothian when it closed one of its depots in 2012.

5. Lothian Buses told us that its business model had confounded economists in the past as they found it difficult to understand that despite being what they classed as a dominant operator, Lothian was not exploiting the market. Lothian told us that it realised this was a barrier of entry for others. Lothian said it was not part of a major group and therefore it was unable to cross-subsidise like some other large operators.

Competition and entry

6. Lothian told us that at the time of the undertakings the MMC was concerned that there would be diminished competition between Midland Bluebird, Strathclyde Buses and to a lesser extent Lowland. Lothian said that there was no real competition between Midland Bluebird and Strathclyde Buses as Midland ran inter-urban routes in to Glasgow and did not operate local or urban city services.

7. Lothian said that it was wrong to focus on competition between bus operators and that all operators saw cars as the main competitor. It told us that authorities deemed that lack of competition was an issue for the bus industry. Lothian said that in some areas competition simply could not be sustained as the returns were not enough for more than one operator. Lothian said that a lot of territory in Central and East Scotland was not viable.

8. Lothian explained that potential competition always existed, but it would have to be where an operator deemed that the investment or strategy could remove the other operator from the market. The entering operator would not enter expecting to share that market in the long term.

9. Lothian told us that it was best to have routes as close to its depots to make driving time as efficient as possible; however, it said it did operate routes with drive time far in excess of 20 minutes. Lothian said that the distance from the route was not necessarily a barrier, but it did impact costs. Lothian said that drive times had not substantially changed since the 2011 Market Review.

Undertakings

10. Lothian felt that the undertakings were the wrong option (in 2002) and FirstGroup's subsequent decline in Central Scotland and East Scotland was as a result of agreeing to follow those undertakings. Divestment would have been more sensible and would have opened up the market far more than was currently possible. Strathclyde Buses was seen as the prize for FirstGroup; its focus went into Glasgow, including investment, and any attention to Scotland East, diminished over time.

11. Lothian said that the perverse outcome of some of the undertakings was that FirstGroup had been unable to exit markets in Scotland East. In a level playing field, it would have done so, and that was both in terms of continuing to run mileage that was not profitable but also being unable to charge fares that would cover the cost of doing so. That also kept out any aggressive competitive environment because there was no point in another operator entering this market if FirstGroup could not exit. Lothian said that this was

where it saw artificial barriers as being introduced. It had artificially closed off the market.

12. Lothian told us that the opening of the North Berwick rail line weakened FirstGroup’s operations in East Lothian and the Borders rail line was also going to seriously impact on FirstGroup’s operations in Mid-Lothian and the Borders. That had happened with West Lothian in terms of the Airdrie-Bathgate rail line opening and to a lesser extent probably in Stirling in Central Scotland.

13. Lothian said it would expect FirstGroup to exit from a number of routes around Edinburgh if the undertakings were lifted. If that happened, Lothian would evaluate the opportunities to see if there was a business case or a long-term prospect of making the operation sustainable.

14. Lothian said that in Scotland, beyond the major urban cities, there was not a great deal of scope for head-to-head competition. The market would not sustain it, and with the increase in rail networks eating into the traditional inter-urban operations then one had to focus on local markets. There was still competition and probably still would be competition, but not on possibly the envisaged basis (ie ‘big guns’ going head-to-head). It was just not sustainable with the populations and the markets that FirstGroup served. Lothian said its focus was very much on constantly delivering and improving for customers because its focus was on keeping people out of cars, and that was how it had built its patronage by keeping fares low, keeping frequencies high and keeping quality even higher.

15. Lothian said that First Scotland East had not invested at times when it probably needed to and, as a result, a number of older buses were still being operated in the region. As a result, customers had been lost to the private car and no other operator was now likely to enter the market as things stood. It said that this was probably a result of the undertakings as First Scotland East had struggled to deliver profits over the last ten years.

16. Lothian did not think that the public had particularly benefited from the undertakings. Lothian said it struggled to actually find anyone who would have benefited.

17. Lothian did not think the undertakings should be varied (rather than lifted). Lothian thought it was a mistake for FirstGroup to have accepted the undertakings in the first place and it had constrained markets throughout Central Scotland and East Scotland.