

Will the Competition Commission find that after waiting ages for a bus, “they all turn up at once”?

August 2009

On 20 August 2009, the OFT published its report on its market study into local bus services (the Report).¹ In short, the OFT is minded to refer the local bus services market in Great Britain, excluding London, to the Competition Commission (CC). There now follows a period of public consultation, ending on 15 October 2009 after which the OFT will consider responses before reaching its final decision to refer or not.

Going by the timetable of markets referred to the CC in recent years, and that are still current², in all four cases the proposed decision was to refer, suggesting that once the OFT has reached a provisional decision to do so, it is almost guaranteed to refer. The average time between the end of the consultation period and the reference was just over 7 weeks. On that basis we could expect a decision (to refer?) from the OFT towards the end November / beginning December 2009.

All four references took the full two years for the CC to reach its final decision. Three were subsequently appealed to the Competition Appeal Tribunal (CAT): Groceries, BAA Airports and Payment Protection Insurance (PPI). The Groceries Inquiry was remitted by the CAT to the CC for reconsideration. Currently the CC is working towards a deadline of 5 October 2009, almost 41 months after the reference. The appeals for BAA Airports and PPI are pending.

In addition, the CC is currently considering Stagecoach's acquisitions in Eastbourne and of Preston Bus. On 6 August 2009, the CC provisionally found against the acquisitions in Eastbourne and is currently consulting on remedies. The CC's provisional decision on Preston Bus is also expected this month. Final decisions on both are expected in October/November 2009.

When can the OFT make a reference to the CC?

The OFT has discretion to refer the local bus services market to the CC if, "it has reasonable grounds for suspecting that any feature, or combination of features, of a market in the

United Kingdom for goods or services prevents, restricts or distorts competition..."³ (Emphasis added). The things that qualify as 'features' are drawn very widely.

If referred to the CC, the CC will itself identify 'features' that have an adverse effect on competition. If it does that, the CC then decides what action should be taken to remedy those adverse effects. The remedies available to it are wide. As an example, in relation to BAA Airports, the CC has recommended that, in order to address adverse effects, BAA divests itself of Gatwick and Stansted airports and one of Edinburgh or Glasgow airport. In addition it has made recommendations on the future economic regulation of airports and on air transport policy to the DfT.

The OFT's basic findings in relation to local bus service markets

The OFT's mission statement is, "to make markets work well for consumers." In the Report the OFT is concerned with whether local bus service markets are sufficiently competitive to deliver quality and value for the consumer. In this case 'the consumer' is both passengers, and LTAs⁴/the tax payer.

Based on the evidence available to it, the basic conclusions reached by the OFT are that:

- it is competition between bus operators, not modes, that is key and that competition between bus operators is, in many local areas, insufficient resulting in higher prices and lower quality for passengers; and
- the cost to the tax payer of tendered services over the last ten years has risen faster than a general transport index or RPI and that weak competition for tendered contracts may be a contributing factor, especially given the limited number of bids for tenders in some areas.

Nevertheless, the Report does not stop there and identifies six features which raise competition concerns.

¹ OFT 1112 con, Local bus services, Report on the market study and proposed decision to make a market investigation reference, August 2009.

² Groceries, Payment Protection Insurance, Rolling Stock and BAA Airports.

³ Section 131 Enterprise Act 2002

⁴ Local transport authorities.

Features identified by the OFT

- **The industry has tended to a situation in which routes, especially non-corridor routes, are served only by a single operator⁵.**
- **Targeted competition of the kind that is designed to eliminate competitors.**
- The **concessionary fares regime**, which is seen as distorting the market by creating an incentive for bus operators to raise fares.
- **Incumbent bus operators** with a well developed network **had little incentive to enter into multi-ticketing arrangements with smaller rivals.**
- **Bus users do not 'shop around' for local bus services**, but are most likely to get on the first bus.
- In relation to tendered services, the **manner in which some LTAs manage competition for tendered services**, when combined with the actions of bus operators.

Evidence relied upon by the OFT⁶

The evidence the OFT appears to be relying upon to conclude it has 'reasonable grounds' in relation to each of the above features, is:

- 1 **Tendency for commercial bus services in local areas to become dominated by a single large bus company** – the OFT has concentrated its analysis on the large national groups: Arriva, First, Go-Ahead, National Express and Stagecoach, thereby ignoring a large part of 'the market'. The OFT looked at the overlap between those operators in terms of depot footprints and route kilometre overlap. To approximate depot footprints, and therefore overlap, the OFT used a 20 minute footprint around depots. Whilst 20 minutes may be the average dead running time from a depot, this would indicate an overly restrictive view of the actual footprint of depots and under-represent the actual, or potential, level of overlap. Note also the use of a 30 minute isochrone analysis in the Cardiff Bus case.

The average route kilometre overlap between operators surveyed was in the range of 20 to 25%. The OFT also calculated that, with respect to commercial services, 35% of LTAs (outside London) are served by only one of the four national groups.

This is a concern as the OFT also concludes, due to its price concentration analysis, that bus markets are not contestable. Although it does conclude that entry is possible it is likely to

be small scale rather than large scale meaning that changes in market concentration are likely to be slow. On this point, it would seem that the OFT is extremely unlikely to change its view without a robust critique of its price concentration analysis which in turn will require access to the base data used by the OFT. The deadline for responses is therefore tight.

- 2 **The prevalence of exclusionary conduct by bus operators** – the OFT's view is that it receives a lot of complaints concerning predation or exclusion in bus markets, yet it has only made one infringement decision relating to buses since March 2000⁷, suggesting not all complaints have merit. The OFT nevertheless concludes that this 'feature' is a concern as "smaller operators in particular at least *perceive* a serious threat of such behaviour." (Emphasis added). There is no exploration of the evidence for such a perception, across a representative sample of local markets, on the part of smaller operators.
- 3 **Concessionary fare regime** – the hypothesis that operators' incentives are to increase single fares to increase reimbursement under the concessionary fares scheme is based on the fact that the OFT's price concentration study found that the average fare is higher in those areas where there is a greater proportion of the population eligible for concessionary fares.

We consider this to be a huge over simplification of the complex arguments that are currently being put in relation to concessionary fare schemes on behalf of operators. As the Report acknowledges, operators are concerned schemes are not revenue neutral despite being designed as such. Does this incentivise operators to raise fares to cross-subsidise the 'loss' on carrying concession passengers?

Perhaps the OFT has been prompted more by the statistic referred to below in terms of Government support – concessionary fare reimbursement alone rose 52% between 2005/06 to 2006/07, no doubt reflecting the introduction of free travel.

- 4 **Incumbent bus operators had little incentive to enter into multi-ticketing arrangements with smaller rivals** – appears to be based on evidence produced by 'one of the trade bodies' and the fact that a survey of all operators found that all had entered into multi-modal ticketing arrangements but only 56% (20 of 36 respondents) had entered into multi-operator (bus) ticketing arrangements⁸. Does "one well informed source" give the OFT 'reasonable grounds' to refer on this point?

⁵ However, the OFT noted that this may be due to (lack of) demand on some routes, in which case it may not be a 'feature'.

⁶ See Chapter 4 of the Report.

⁷ OFT, 2008, Abuse of a dominant position by Cardiff Bus. Burges Salmon LLP acted for Cardiff Bus.

⁸ See paragraphs 4.33 and 4.34.

5 **Conduct of passengers** – evidence from operators that brands generally are not strong and that consumers are happy to use rival buses if they arrived at a stop first. This may encourage 'over-bussing', otherwise viewed by the OFT as exclusionary behaviour. This consumer behaviour may have facilitated such exclusionary practices.

6 **The manner in which some LTAs manage competition for tendered services** – here the OFT has acknowledged that the data on which it has based its analysis is incomplete, and has concentrated on average bids per tender across PTEs and some non-PTE LTAs. Overall the average number of bids per tender was 2.95 across the 11 areas looked at. It was noted that in West Yorkshire (27% of PTE contracts and 24% of all contracts considered by the OFT) the average number of bids was 1.1 which suggests that statistic is distorting the overall average. Of the 11 areas looked at, 7 had an average bid of 2.9 or over which suggests this issue is very localised. In addition the OFT appears to have underestimated the strength of competition from smaller operators 'for the market'.

With this feature, however, the OFT appears to be focused more on the behaviour of the LTA when designing and tendering the contract. Undoubtedly the OFT is also driven by the statistic that between 2000/01 and 2006/07 spending on concessionary and supported services rose 93% in nominal terms. In 2006/07 Government support amounted to £1.2 billion, representing almost 33% of the total revenue of bus operators.

Potential remedies

It may be premature to talk of remedies. One observation however is that the potential remedies identified by the OFT refer to the new regulatory regime introduced by the Local Transport Act 2008. In addition to that, LTAs already have the power, under the Transport Act 2000, to introduce ticketing schemes and DfT is out to consultation on the concessionary fares regime. Whilst the OFT may have identified competition concerns should it not allow the 'new regulatory regime' to bed down, await the outcome of DfT's consultation and encourage LTAs to pursue ticketing schemes (if that really is an issue) and best practice in the management of competition for tendered services before making a market investigation reference?

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