COMPETITION COMMISSION

LOCAL BUS SERVICES MARKET INVESIGATION

Provisional findings on tacit coordination

Introduction

1. In the CC's Updated Issues Statement, published on 10 September 2010, we set out a theory of harm on geographic market sharing, aimed at assessing whether tacit coordination might impact on competition in the provision of local bus services. In paragraph 8.189 of the provisional findings report we said that we were unable to conclude with respect to the tacit coordination theory of harm because, at a late stage in the process, we had received internal papers from some operators which included evidence relevant to our assessment.

2. We indicated that we intended to publish a separate provisional decision on tacit coordination. This addendum to the provisional findings therefore presents the qualitative evidence we have received and evaluated to date that is relevant to our consideration of that particular theory of harm, and sets out our provisional findings in relation to it.

Stability of the market

3. Evidence on entry and expansion is set out in Section 6 of the provisional findings report. This concludes that the market structure is generally stable.[1] Of particular relevance to the consideration of tacit coordination is the behaviour of the largest operators, which is presented in paragraph 6.100. This concluded that:

[1] In particular we found that larger-scale entry or expansion is rare. 12 per cent of Urban Areas experienced entry by at least one of the Large, Mid-Sized, or Tier 1 Small Operators in the five years to spring 2010 and most of the entry events were small scale. Approximately 4 per cent of areas experienced an entry event involving a change in share of supply of 10 per cent or more between 2008 and 2009. See the provisional findings report, paragraphs 6.72 & 6.73.

(a) of the Large Operators, only Go-Ahead and Stagecoach have actively sought to enter new areas in a significant way and in competition with other Large Operators;

(b) Arriva's entry into new areas was confined to a few routes, some of which were in competition with other Large Operators;

(c) FirstGroup's entry events have been concentrated on areas around Glasgow and have not been in competition with any of the Large Operators; and

(d) National Express has not entered into any new area.

4. In paragraph 8.179 of the provisional findings, we relayed operators' views that there were a number of areas where there has been competition between the Large Operators for many years. In particular, Arriva gave us examples of Leicester, Wirral, Wigan, Glasgow, Southend and West Yorkshire where it told us that it competed with FirstGroup. It also told us that it competed with Stagecoach in Liverpool/Southport, South Manchester, South Yorkshire, north Newcastle and Teesside. Stagecoach noted that it had competed with FirstGroup in Bolton and with Arriva in Darlington for several years, but that it exited these areas because its operations were not profit-able. Our review of internal documents, however, suggests a lack of active head-to-head competition between the Large Operators in several areas where they have neighbouring operations:

(a) FirstGroup's internal documents do not suggest that there is active competition for commercial services in Greater Manchester, despite the close proximity of its operations to those of Stagecoach.[2] There are also many markets where the Large Operators provide competing services on the key corridors but not on any other routes and where there appears to be very little head-to-head competition.

[2] FirstGroup told us that the threat of expansion by local rivals led it to review its services constantly. It said that it had identified few viable 'gaps' to exploit in rivals' networks in South Manchester. In addition a traffic regulation condition (TRC) applied in Manchester city centre which would affect FirstGroup's ability to offer a reliable cross city service.

For example, in Aberdeen (Stagecoach and FirstGroup),[3] Newcastle (Stagecoach, Arriva, Go-Ahead), West Yorkshire, including Leeds (FirstGroup, Arriva), Essex (FirstGroup, Arriva).

(b) In West Yorkshire, Arriva's documents do not mention competition with FirstGroup at any time over the last three years. Arriva noted in an Ops Report in June 2009 that FirstGroup was planning a 4 per cent reduction in operated mileage, which had been heavily criticized by [✂]. Arriva's internal documents do not, however, suggest that the company considered whether this might create opportunities. In its internal documents, FirstGroup noted that 'there has been no change to the share of bus service provision in the Leeds area for some time' and that 'the competition situation is unchanged with Arriva reducing frequency rather than looking to expand'.[4] This example illustrates that a service reduction by an incumbent operator did not seem to induce nearby rivals to consider a response. This might indicate a reluctance to compete, however, it was also put to us that the service reduction may have reflected a change in the viability of the routes in question, in which case no profitable opportunity for expansion would have arisen.[5]

(c) In Berkshire, FirstGroup's internal papers noted the proximity of other Large Operators, but did not consider these to pose a threat to its operation. In particular, FirstGroup's competition with Arriva on one route was described in dismissive terms:

> We are surrounded by two of the other major Groups, but there is no evidence that our neighbours to the south (Stagecoach in Aldershot and Arriva in Guildford) or to the north (Arriva in High Wycombe) have any aggressive designs on our area. However, the

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[3] FirstGroup said that the routes that did not face competition in Aberdeen had low demand.
[4] FirstGroup said that between October 2009 and October 2010 it had seen its share of supply decline by 9.6 per cent.
[5] Arriva said that it had assumed that FirstGroup would have reduced mileage on its least profitable routes. Given this presumed low profitability, Arriva did not consider that a profitable opportunity had arisen. Arriva also noted that this was a difficult period in Yorkshire partly because of [✂]. As a consequence Arriva also introduced cost saving measures in Autumn 2009.

rather ridiculous competition between ourselves and Arriva between Slough and High Wycombe is likely to continue unless the law changes to permit discussion between operators of services that could be provided more cost effectively in a coordinated manner.

These documents suggest that within FirstGroup's Berkshire operation there is a general expectation that other locally based Large Operators are unlikely to expand their operations in Slough. FirstGroup said that routes did not face head-to-head competition because of insufficient demand as car ownership in Slough was above the national average.

5. We note that both tacit coordination and barriers to entry, including the expectation of a costly period of intense competition post entry can explain the behaviours described in paragraph 4. However, our provisional findings on barriers to entry (particularly the expectation of intense competition) and tacit coordination within an area are not mutually exclusive explanations of these behaviours. FirstGroup also noted that incumbents' reactions to potential competition and demand demographics were other alternative explanations for a lack of head-to-head competition.

6. As noted in paragraph 6.100 of the provisional findings, Stagecoach and Go-Ahead have been more proactive in entering markets in competition with other Large Operators than Arriva, FirstGroup or National Express. This would appear in-consistent with the hypothesis that all Large Operators engage in tacit coordination between geographic areas, but does not rule out that tacit coordination may occur within existing areas of operation.

7. In particular, Stagecoach has entered North Devon and Sheffield in the last five years and in both cases actively competed with FirstGroup to gain market share. It has also competed strongly with FirstGroup in the Cumbernauld area, as evidenced by

FirstGroup's internal papers. As set out in paragraph 8.6 of Stagecoach's non-confidential response to the provisional findings, Stagecoach pursued an opportunity to enter the Leeds area in 2006, but failed to win the tenders that would have enabled this expansion.

8. Similarly, Go-Ahead has bought operations in both Norfolk and Plymouth and by doing so placed itself in direct competition with FirstGroup. It has also actively considered buying Ipswich Buses, which would have put it in direct competition with FirstGroup.

Responses to entry which are consistent with tacit coordination

9. As noted in paragraph 8.159 of the provisional findings, we might, under coordination, see occasional periods of competition occurring if there were any cases where coordinated behaviours broke down, which could happen occasionally if operators thought opportunities had emerged. It is likely that we would then see measures taken by those operators that were affected by entry against them. This would not necessarily be conscious and deliberate 'retaliation' but may be patterns of entry against rivals in response to a realization that mutual interests in not competing had broken down. If costly competition then resulted, it may then encourage a return to coordinated behaviours.

10. Our review of internal documents has shown that there have been several occasions where local bus operators have either actively considered retaliating on other routes in order to encourage a new entrant to withdraw a service recently launched against themselves or have carried out such strategies. We have also found evidence of signalling strategies in some internal documents.

11. [✂]

12. In [Town A], [Operator 1's] internal documents suggest that it responded to [Operator 2's] entry on to one of its routes by responding on another: [✂].

13. However, following [Operator 2's] deregistration of its service to [✂], [Operator 1] did not reciprocate and it continued to operate its services [✂] in competition with [Operator 2] until [✂]. [Operator 2's] documents do not reveal an understanding of a signalling strategy by [Operator 1] and show that [Operator 2] considers that it competes with [Operator 1] extensively throughout [Town A].

14. FirstGroup's internal documents show that, where its routes have been entered by Stagecoach, FirstGroup has considered retaliation against Stagecoach elsewhere but has generally refrained from adopting such a strategy (aside from the reference to the Ayrshire example in the 1990s discussed below):

    (a) In North Devon—FirstGroup considered retaliating in Exeter, but rejected this option, as shown in the North Devon case study.[6]

    (b) In Scotland—one FirstGroup strategy paper notes

    > there is a clearly a longer history to First/Stagecoach competition in Glasgow with a pedigree that goes back to 1996/1997. This includes the episode whereby we opened a depot in Ayrshire specifically to compete with Stagecoach (revenue of circa £1m/year) after Stagecoach entered the Glasgow city market.

    FirstGroup told us that this was a historic situation (and so, in its view, did not reflect how competition currently operated) and that the comment was speculation by a FirstGroup employee who was not in post at the time to which he refers and so had no direct knowledge of the rationale behind the depot opening. We also note that Fife Council's understanding of the situation is consistent with FirstGroup's internal report:

[6] See Appendix 6.4 of the provisional findings for details.

In 1997/1998, Stagecoach registered services in Glasgow (First Glasgow territory) and bought over A1 Service in Ayrshire. In open ‘retaliation,’ First Group launched a competing service on the Ardrossan to Kilmarnock route (Ayrshire) and established FirstFife - a company running a high frequency route from Fife to Edinburgh. The competition lasted less than 2 years and, when Stagecoach Glasgow deregistered most of its Glasgow services, the First competition in Ayrshire and Fife was also deregistered soon after. This particular story is common knowledge throughout the industry though may be disputed by some of the players involved at the time.

(c) In Yorkshire—FirstGroup’s strategy documents consider ‘pre-emptive / “disciplinary”’ action against Stagecoach in Sheffield in order ‘to inhibit potential reaction from [Stagecoach] in other parts of the UK which are suffering similar competitive pressure’. The documents also note that First South Yorkshire would ‘look for opportunities to damage [Stagecoach]’s route dominance in other areas’; and that First South Yorkshire aimed to ‘hit [Stagecoach] hard, and let them know (probably contrary to their expectations) that we will defend our territory and attack theirs.’ The documents were not specific about in which other parts of the UK it considered responding. FirstGroup told us that these documents recorded operating company suggestions on how to react to the threat of Stagecoach and the decline in revenues that it had experienced. The suggestions had not been acted upon other than to put in place some limited price changes in Sheffield.

15. In response to our market questionnaire, one small operator, [✂] indicated that it had responded to competition by [✂] on one of its routes ‘by registering against them on an entirely different route and eventually after another 12 months they withdrew’.

16. Further relevant evidence on potential tacit coordination between Arriva and FirstGroup concerns their competition in Cheshire between 2007 and 2010. Following the acquisition of Chester City Transport by FirstGroup, Arriva launched competing services on the three most profitable routes in Chester in July 2007.[7] Following Arriva's registrations, FirstGroup launched a service competing with Arriva in the Wirral, linking this to the competitive situation in Chester. Arriva responded by launching a new service in competition with FirstGroup in Birkenhead, which it later withdrew to signal to FirstGroup that it should withdraw its Wirral service. The signalling strategies of the two companies are recorded in the board papers of their relevant local bus operations (the relevant extracts of which are shown in Annex 1). The internal documents suggest that notwithstanding the signals exchanged by the two operators they failed to achieve an understanding of the division of routes between them.

17. In addition, in paragraph 6.135*(e)* of the provisional findings, we referred to a paper presented to FirstGroup's UK bus board on 10 October 2007, in which it discussed FirstGroup's registration of service 32/33 on the Wirral. This paper notes the history of competition in Chester between Arriva and FirstGroup and notes that: 'as another retaliatory measure, First Potteries have started to compete on existing Arriva routes in the Wirral—however, these routes are currently losing circa (£3k) per week'. FirstGroup later withdrew this service, hoping that it would in turn 'encourage our competitor in Chester [Arriva] to withdraw from Blacon'.

18. FirstGroup told us that this was an isolated incident and 'management speculation that Arriva may have considered withdrawing one or more of its loss-making routes in Chester was ultimately not the case'. [✂]

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[7] The events that preceded these registrations are described in paragraph 6.82 of the provisional findings.

19. FirstGroup raised a number of specific points in response to this evidence:

(a) the events referred to were highly contentious (including applications for court injunctions and involvement of the Traffic Commissioner);

(b) the level of competition was manifestly unsustainable (FirstGroup made losses in excess of £[✂]);

(c) the attention of the group was diverted to its US operations during this period;

(d) vigorous competition continued until a Voluntary Quality Partnership was introduced by Chester County Council;

(e) [✂]; and

(f) any ‘strategy’ of retaliation or signalling (if there ever was one) was clearly not successful.

20. Overall, FirstGroup considered that this chain of events was, in fact, an example of ‘unsustainable head-to-head competition’. It considered that whatever attempts may have been made to limit competition through tacit coordination (a proposition which it does not accept) it is evident that these attempts failed because vigorous competition continued unabated until the introduction of a voluntary quality partnership (VQP) by Chester County Council led to a sustainable competitive outcome.

21. Arriva told us that there was no explicit link between competition in Chester and the Wirral. It also noted that at many points it was uncertain as to the likely reaction of FirstGroup and that some planned actions were not in fact implemented.[8]

22. The lack of an explicit link between Chester and the Wirral would appear to be consistent with our general reading of this episode as an ultimately unsuccessful attempt at tacit coordination. In other words FirstGroup and Arriva failed to arrive at a

[8] In particular its intention to defend its New Brighton–Liverpool and West Kirby–Liverpool corridors if there continued to be no favourable reaction from FirstGroup.

focal point for tacit coordination because of confusion regarding the division of routes between them (ie the first condition for tacit coordination).

Conclusion

23. We have considered the evidence reviewed above in conjunction with the material in paragraphs 8.147 to 8.184 of the provisional findings, namely: our assessment of the necessary conditions for tacit coordination, the views of market participants and the evidence from depot margins.

24. As set out in paragraph 8.188 of the provisional findings, we have found that the conditions for tacit coordination in the form of geographic market sharing hold in relation to local bus services within areas. However, we found that the conditions are less likely to hold in relation to geographic market sharing across areas, ie tacit coordination is less likely to constrain entry into completely new areas of operation, but may affect the willingness of operators to engage in head-to-head competition within the areas in which they already operate.

25. Our consideration of tacit coordination therefore concentrates on Large Operators' actions within areas. As discussed in paragraph 4 above we have found evidence that, in some areas, Large Operators do not appear to engage in active head-to-head competition despite the proximity of neighbouring operations.

26. We have also observed instances where, following entry by a rival, incumbent operators have considered or engaged in retaliatory action on other services in the area. We have also found evidence in the internal documents of some operators which shows that those operators have in at least one local case tried to signal to rivals so as to encourage or maintain a geographic separation of their operations. This indicates a clear attempt by two Large Operators to bring about tacit coor-

dination, and that those operators had some expectation that a signalling strategy might succeed in establishing a tacit understanding. While this attempt appears to have failed, it is a clear indication that circumstances can arise in which local bus operators will prefer not to compete.

27. Directly observing tacit coordination is challenging in that, if coordination is successful, it would lead to operators refraining from undertaking certain competitive actions. Consequently there may be no direct actions to observe unless attempts at coordination are disrupted.

28. We acknowledge that the number of instances of which we have seen evidence of attempted tacit coordination or behaviour consistent with this is not large, and there are also cases of Large Operators choosing to compete against each other. We also acknowledge that the behaviours we have observed that look like attempts at signalling do not seem to have then led directly to stable coordination. This suggests that either attempts at signalling have not been recognized or that other factors have disrupted the establishment of tacit coordination. However, the fact that attempts have been made supports our finding that the conditions for tacit coordination hold.

29. Our previous findings on the existence of barriers to entry and expansion provide an alternative explanation, to tacit coordination, for any reluctance on the part of operators to engage in head-to-head competition. In other words, operators may be wary of engaging in head-to-head competition because of their expectation of high-intensity competition post entry rather than as a result of a successful signalling strategy.

30. On the basis of the material assessed for the purposes of evaluating this theory of harm, we have not found evidence which would clearly establish the existence of

tacit coordination in the provision of local bus services across the reference area, or clear examples of tacit coordination being established or maintained successfully in local markets. While we therefore provisionally conclude on the basis of this evidence that tacit coordination cannot be said to be a feature of local markets giving rise to an AEC, we have found that the conditions for coordination are met and we have observed that some operators have on occasions tried to coordinate. Therefore, we cannot dismiss the possibility that operators in some local areas may have achieved, or may in the future achieve, a tacit understanding to refrain from head-to-head competition, and there seems every reason to be concerned about the potential for tacit coordination.

Side-by-side review of FirstGroup and Arriva's internal documents on competition in Cheshire

Note that the key statements are in red, bold font.

Month	*Arriva*	*FirstGroup*
[✂]	[✂]	
[✂]	[✂]	
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
[✂]	[✂]	[✂]
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[✂]	[✂]	[✂]
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ANNEX 2

Copy of [✂] paper to [✂] UK Bus Board

[✂]