

6 Conclusions

6.1. Under the reference dated 15 December 1992, full details of which are set out in Appendix 1.1, we are required to consider whether a monopoly situation exists in relation to the supply of bus services in the area of Mid and West Kent (defined as the districts of Maidstone, Rochester upon Medway, Gillingham, Swale, Tonbridge and Malling, Tunbridge Wells, Sevenoaks and Gravesham in the county of Kent) and, if so, by virtue of which provisions of sections 6 to 8 of the Fair Trading Act 1973 (the Act) that monopoly situation is to be taken to exist, and in favour of what person or persons that monopoly situation exists.

6.2. A monopoly situation in relation to the supply of services of any description in the UK shall be taken to exist under section 7(1)(a) of the Act when at least one-quarter of the supply is by or to the same person.

6.3. As noted in paragraph 3.57, we estimate that in November 1992 The Maidstone & District Motor Services Ltd (M&D) supplied some 62 per cent of bus services in the reference area, as defined above, measured by bus miles. We have no reason to believe that the situation has changed significantly. We therefore conclude that a monopoly situation exists in relation to the supply of bus services within the reference area.

6.4. We are required to consider in whose favour the monopoly situation we have identified exists. M&D is a wholly-owned subsidiary of Einkorn Limited (Einkorn), a company formed in June 1986 by M&D's five senior managers for the purpose of acquiring M&D on the privatization and splitting up of the National Bus Company (NBC). We conclude that the monopoly situation exists in favour of M&D and of Einkorn.

6.5. In accordance with our terms of reference we have therefore to consider:

- (a) whether any steps (by way of uncompetitive practices or otherwise) are being taken by M&D for the purpose of exploiting or maintaining the monopoly situation and, if so, by what uncompetitive practices or in what other way;
- (b) whether any action or omission on the part of M&D is attributable to the existence of the monopoly situation, and, if so, what action or omission and in what way it is attributable; and
- (c) whether any facts found in pursuance of our investigation operate, or may be expected to operate, against the public interest.

The market

6.6. In recent years, the use of buses has fallen sharply in the reference area; passengers carried by M&D fell by about one-third over the period 1985 to 1992. Bus services in the reference area face competition from other forms of transport, in particular cars and train services. The ownership of cars in the area, and the proportion of households with a second car, are both well above the national average. There is also a network of rail services which, although primarily used for London commuter services, also provide an alternative to buses for some local movements. In our view, however, there is a distinct market for bus services in the reference area in that the demand includes a captive component of essential journeys. Bus services remain an important means of transport essential to the mobility of households without cars, in both the towns and the rural areas covered by the reference, in particular for pensioners, schoolchildren and those with below-average incomes.

6.7. Deregulation following the Transport Act 1985 (the 1985 Act) has led to substantial changes in the bus market in the reference area. At that time most local bus services in the reference area were provided by the NBC, through its M&D subsidiary, and within the Maidstone area by Maidstone Borough Council (MBC). Now there are just over 20 bus operators providing such services in Mid and West Kent. Most are small operators with a few buses, indeed some with only a single bus, and many primarily engaged in individual hire services or tendered services. M&D remains by far the largest operator with a network of commercial and tendered services throughout the area. Although it also runs commuter and daytime coach services to Central London and some contract and private hire services, revenue from local bus routes accounted in 1991/92 for [*] per cent of total revenue. Two other substantial bus companies, East Kent Road Car Company Limited (East Kent) and Kentish Bus & Coach Company Ltd (Kentish Bus), both like M&D ex-NBC subsidiaries, are centred in adjacent areas and operate some commercial and tendered services in the edges of the reference area: East Kent in Swale and Kentish Bus in the Gravesham, Tonbridge and Tunbridge Wells areas. There is little head-to-head competition, however, between M&D and these major operators.

6.8. M&D has retained broadly the same organization and geographic network of services throughout the reference area that it operated in 1985 though a number of evening and Sunday commercial services have been withdrawn. It operates local service networks in the Medway towns, Maidstone, Tonbridge, Tunbridge Wells, Sittingbourne and Sheerness, with supporting inter-urban and rural services. M&D has also extended its network to cover the Maidstone town services earlier provided by the MBC-owned company, Boro'line. Under the 1985 Act this operation had to be operated at arm's length from the local authority and without financial support. Following an expansion into London operations, heavy losses were incurred and in late 1991 Boro'line was put up for sale. The London operations were sold but the remaining operations went into administrative receivership early in 1992. M&D had registered bus departure times in front of most of Boro'line's services in late 1991 and a period of intense competition ensued in both the Maidstone and Chatham areas. Boro'line ceased operating in May 1992 and its remaining assets were purchased by M&D and Einkorn.

6.9. Since deregulation most of M&D's evening and Sunday local services and a number of rural services have been withdrawn as commercial services and replaced with tendered services by Kent County Council (KCC). Although M&D initially won the majority of these tenders, other operators have recently been more successful; [
Details omitted. See note on page iv.]

6.10. A number of small operators have entered the market by bidding for tendered services in the reference area and since 1987 a few have also registered commercial services on routes served by M&D. A major coach operator, Shearings Coach & Bus (Shearings), also entered the market by bidding for local tendered services and introducing some commercial services. All of these operators have either left the local market completely or withdrawn from direct competition with M&D on commercial services with the exception of three which have all entered the local bus market in the last three years: Mercury Passenger and Airport Shuttle Services (Mercury) in competition with M&D in the Chatham and Isle of Grain areas, and Bygone Tours & Bygone Buses (Bygone) and Turners of Maidstone (Turners) in Maidstone. In the closing stages of our inquiry Bygone told the Traffic Commissioner, on 4 June, that it intended to cease providing registered local bus services but on 10 June took steps to reinstate its registrations. Complaints from these operators about M&D's actions on competitive routes played a large part in the present reference but we have also received comments and criticisms from other small operators and from local authorities, including KCC.

The public interest

6.11. A great deal of evidence and many specific complaints, mainly from other operators, were put to us about M&D's response to competition in the reference area. The matters we have considered fall under a number of heads:

*Figure omitted. See note on page iv.

- (a) specific complaints about the frequency, timing and operation of services (including allegations of obstruction and running of unregistered buses), and about fares charged on the routes where there is competition;
- (b) concerns about the attitude of the dominant operator on ticketing arrangements, the provision of timetable information and access to poles, flags, and information cases; and
- (c) access to the Pentagon Bus Station in Chatham.

6.12. We consider the various alleged practices in turn. First, however, we consider as relevant background some general factors influencing entry to the industry and M&D's overall cost and revenue structure, including the extent of cross-subsidy within the network and the extent to which operations on competitive routes are being supported by the rest of M&D's operations.

Barriers to competitive entry

6.13. Immediate barriers to entry and exit in the bus industry are small for an operator seeking a niche opportunity. Second-hand buses and qualified drivers are readily available and an operator can start on a small scale, usually seeking private hire or tender work. Sunk costs are small. There are a considerable number of operations of this type in the reference area. However, this is not an easy market for small firms to expand in. They are likely to be at a disadvantage to a larger and long-standing operator with greater resources, which is better placed to offer return and network tickets and to be recognized and established in concessionary arrangements. New entrants have to build up awareness of their service timings and routes and may find it difficult to inform potential passengers of their services. A further major deterrent is the ability of an incumbent to retaliate against a new entrant by lowering fares, or increasing frequency or retiming and rerouting services. Some established operators have acquired a reputation for 'seeing off' the competition and this is often quoted as one of the main deterrents to establishing entry in the bus industry.

The financial basis of M&D's operations

6.14. As shown in paragraph 2.16, M&D is making modest profits. Its pre-tax return on turnover in 1991/92, at 4.2 per cent, was not sufficient to cover its bus replacement costs. It does, however, have sufficient resources to engage in predatory action against a smaller operator if it wishes to do so.

6.15. There are considerable difficulties in moving beyond the overall financial performance of the company to consider the costs, revenues and profitability of its individual routes, particularly those on which competition is occurring. In the detailed operation of the network not only are depot and general overhead costs to be allocated but drivers and buses can move from route to route within the operating day. Revenues, particularly off-bus revenues from season tickets, Freedom tickets and school buses, also have to be allocated to individual routes, often on the basis of surveys and M&D's general knowledge of the current traffic patterns. M&D's method of fully allocating costs and revenues for the preparation of operating results dates from before deregulation, and met the needs of the subsidized and regulated industry at that time. It is far less satisfactory for measuring the performance of individual routes and presents considerable problems for any outsider trying to do so.

6.16. M&D records information on costs for individual services, as a necessary prerequisite for producing information on route groupings. It told us that in its view the performance of its local bus services could only be measured in terms of these route groupings, which reflected natural catchment areas, passenger flows and operating patterns. M&D's analysis for the first ten costing periods of 1992/93 showed 54 route groupings consisting of 185 individual routes. The results for the individual routes showed (see paragraph 2.46(b)) that a large number of individual routes were not covering their semi-variable costs (maintenance and depreciation); a few were not covering variable costs.

6.17. M&D told us that its long-term aim was that all route groupings should pay their way but that it did operate services where revenues did not cover full costs. It regarded this as a sensible policy and inevitable in any network of bus services. As shown in paragraph 2.46(a), for the first three quarters of the current year,

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Details omitted. See note on page iv.

] While there is little correlation between the level of profit and the presence of competition on a route, [

Details omitted. See note on page iv.

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6.18. M&D argued that these operational costings based on a full cost allocation system could not be the basis for day-to-day managerial decisions on service adjustments. It told us that, following a thorough review of the network after privatization when a large number of commercial evening and Sunday services had been withdrawn, there had been only marginal change in its network. Route profitability had been kept under review and a few routes had been relinquished. Managers mostly made changes by rescheduling and redeploying buses and drivers as opportunities arose at different depots and for this purpose used an incremental approach. Under this incremental approach, in considering operational changes, whether or not in response to competition, an estimate of the revenue likely to be directly generated was compared with the costs that would be incurred by the proposed change. What costs were taken into account would vary from case to case; where buses and drivers were free or not fully occupied throughout the day, the extra costs were limited to fuel, tyres and maintenance. For example, the extra journeys introduced in September 1992 on routes 82/83, 85 and 89 had been manned by a special roster of staff who were surplus because the usual loss of drivers over the summer break had not occurred in 1992. In any event M&D claimed that all the routes running against competition were covering variable costs except numbers 113/114, 138 and 151 which had been withdrawn early this year.

6.19. M&D told us that it had to act to preserve its revenues and the profitability of the network on the routes where competition had entered. Like most substantial incumbent operators it offers a network of services. Revenue from such network routes is seen as interdependent and it is common practice for cross-subsidization to occur between routes. In deregulating the industry, Ministers accepted that cross-subsidization between routes may be commercially justified, eg to protect feeder traffic or encourage the continuing use of buses. The incumbent is, however, then vulnerable to entry on its more profitable routes. He may fear losing not only the profits of that route but the benefits to his network in enabling him to spread his overhead costs and absorb the costs of less profitable routes. M&D argued that, in judging its response to new entry, we should accept its incremental approach, in particular its decisions to introduce numbers of extra buses on some routes.

6.20. The main difficulty with this argument is that, if a large operator takes a very short-term approach, and if it has large numbers of drivers and buses and a margin of spare capacity, which is likely because of the operational needs of its network, variable costs on this basis will be low, if not negligible. It is therefore likely that on this approach almost any service changes an incumbent bus company decides to take can be immediately justified. Nor will it be possible for an outside body to satisfy itself on the soundness of the evidence. We consider that the costs and revenues from such action must be measured over a longer period and with a realistic allocation of both variable and semi-variable costs, noting that the provision of services even on this basis requires the ability to cross-subsidize them from other more profitable routes. We also consider that the introduction of additional competitive journeys is likely to be predatory if the revenue generated by such journeys fails to cover short-run variable and semi-variable costs and the firm incurs losses which it could avoid in an attempt to damage its rivals. There is clearly room for argument about the extent to which costs can be avoided for the company taken as a whole. For example, a resource surplus to requirements in one part of the company may be of use elsewhere in the company. For a certain time the company may have to pay for the resource whether it uses it or not. Whether the cost of this resource can or cannot be avoided depends on the minimum period for which it must be incurred. Use of the resource beyond this minimum period means that the cost is avoidable and is therefore properly regarded as a cost of any competitive response.

6.21. M&D gave us detailed figures on which it had based the competitive response for four routes, the 82/83, 85, 89 and 191 routes. For the 191 route M&D was able to produce detailed revenue estimates for only one of the

journeys introduced and the position was complicated by the withdrawal of some of the competitor's services. We were, therefore, unable to reach a firm view on whether the revenue arising from the additional journeys covered variable and semi-variable costs. On M&D's own estimates of additional revenue it is clear that on the 82/83, 85 and 89 routes the additional journeys were not covering variable and semi-variable costs (see paragraph 2.51). We conclude that, where the operation by M&D of additional journeys on such routes does not cover variable and semi-variable costs, this is a step taken by M&D to maintain its monopoly position, and that, for the reasons given above, it is intended to encourage the withdrawal of the competitor. We consider that this will lead to adverse effects for customers through the loss of services and the fares offered on them where these are lower than those charged by M&D on the route, together with the loss of potential benefits of choice and lower prices if competition had been maintained. We consider that the practice operates or may be expected to operate against the public interest.

6.22. We now examine in more detail the various alleged practices and consider whether they may operate against the public interest even where they meet the criteria set out above of covering variable and semi-variable costs. This requires us to consider, among other aspects, the intention of the conduct. Judging intent is not easy but we see value in this approach not only in cases where costs are not covered but in cases where the action may be virtually costless, eg by changing service timings or by impeding or denying access to a competitor. We consider that intent is better inferred from the actual behaviour of the companies concerned rather than their statements. Relevant factors here will be the scale and timing of the response, what form it has taken and most importantly how selective it has been. Such factors allow a distinction to be drawn between a response designed to improve the performance and profitability of the company by benefiting customers and one designed solely to damage rivals.

Operating unregistered buses

6.23. A large number of allegations have been put to us by Bygone and Turners that M&D was running unregistered buses against their services. Registration requirements are explained in paragraph 3.6. A number of these allegations were examined at an inquiry held by the Traffic Commissioner for the South Eastern and Metropolitan Traffic Area during the period of our own inquiry. He found that during the period September to November 1992 M&D had run numbers of extra journeys on the 82, 85 and 89 routes during the 42-day period before the registrations should have come into effect. We received allegations from Bygone and Turners, which were denied by M&D, of further breaches during our inquiry and we commissioned our own survey, carried out by the Vehicle Inspectorate Executive Agency (VIEA), for a week in February 1993. This showed a number of runnings that the VIEA was unable to match to registrations. These, however, in the main were traced to incomplete identifications and to the defects in M&D's registration procedures (see paragraph 3.178), which had apparently resulted from a genuine misunderstanding between M&D and the Traffic Commissioner's staff on which services had been withdrawn and which remained registered. The procedures have now been rectified and the Traffic Commissioner has accepted that the services are registered.

6.24. In respect of the services operated by M&D early in 1993 while these were technically unregistered, we accept that a genuine mistake occurred which has been put right. However, we consider the running of unregistered services during the period September to November 1992 to be a step taken by M&D to maintain its monopoly position. The registration requirements under the 1985 Act were designed to give passengers reasonable certainty of levels of service and to provide a fair basis for competition. We note the Traffic Commissioner's view that M&D, in operating these services, intentionally interfered with another operator's services. We consider that this behaviour by M&D operates or may be expected to operate against the public interest.

Operating unnecessary duplicate buses

6.25. We received a number of complaints from Bygone and Turners that M&D was running duplicates (additional buses designed to meet extra and unforeseen demand (see paragraphs 3.160 and 3.161)) to blanket the routes on which they were competing. M&D assured us that its policy was only to run duplicates where passenger needs required them and denied running unnecessary duplicates on those routes. Our own investigations (see

paragraph 3.177) suggested that buses which appeared to be duplicates were in fact closely spaced registrations, and we discuss these below, in paragraphs 6.29 to 6.32.

Failing to operate the full registered route

6.26. We received a number of allegations from Bygone and Turners that M&D drivers had on occasion deliberately cut out portions of route in order to keep ahead of their buses. A particular example given was the detour into Loose Village from the main Maidstone-Coxheath route. M&D denied that these variations had occurred and stated that it always operated the full route except when prevented by reasons outside its control, eg congestion, breakdowns or accidents. Our own survey, although limited, disclosed no evidence of any variations. We consider that the evidence available does not support any finding under the Act.

Registering and operating commercial services against a competitor's tendered services

6.27. We have described the arrangements for KCC tendered services in paragraphs 3.100 to 3.113. M&D's bidding for and operation of tendered services does not in general appear to raise any public interest issues. We have, however, received a number of allegations that M&D has registered and operated commercial services against another operator's tendered service. M&D told us that it had never registered a route commercially in response to losing or failing to gain the tendered service on it; it had, however, registered over all or part of three tendered routes operated by its competitors. The circumstances are described in paragraphs 3.115 to 3.120. M&D made clear that they were responses to competitive action by the other operators on these or related routes. The registrations against Shearings and Nu-Venture Coaches Ltd were followed in due course by the withdrawal of these companies' services in direct competition with M&D. On the third, M&D has withdrawn its services as financially unprofitable. In all three cases it was clear that the M&D services could not expect to be commercially viable but were designed to abstract revenue that the successful tenderer could expect (all being fixed price rather than guaranteed revenue contracts).

6.28. We recognize that to some extent tendered services abstract revenue from commercial services operating over the same route or corridor and that some response by the commercial operator may in some circumstances be justified. We consider M&D's action in registering commercial services against tendered services in these three cases, where operators had engaged in direct commercial competition on other routes, to be a step taken to maintain the monopoly situation and designed to persuade the competitor to withdraw the directly competing, or other competing, services, with the adverse effect of depriving consumers of the benefits of the additional services. This conduct operates or may be expected to operate against the public interest.

Registering and operating additional services immediately before a competitor's services

6.29. M&D has used the practice of registering before a competitor on a number of occasions in recent years. When Boro'line was in difficulties at the end of 1991 M&D registered three minutes ahead of almost all Boro'line's Maidstone services. More recently M&D has responded to the presence of Bygone and Mercury on some of its routes by registering additional journeys and by rescheduling others, as described in paragraphs 3.128 to 3.159. For example, on routes 82/83 and 85 M&D registered journeys to run three minutes before almost all Bygone's journeys, although Bygone's departure times had mainly been introduced between, rather than against, M&D's journeys. On the 190 group of routes M&D registered a few minutes before Mercury journeys on the route, some of which had themselves been introduced in front of M&D's own journeys. Certain of these services on the 82, 85 and 89 were withdrawn on 19 March by orders of the Traffic Commissioner and revised schedules, less intensive than those operating before the withdrawals but still mostly timed before competitors' journeys, were introduced by M&D on 7 June at the expiry of the ban.

6.30. The practice of registering before competitors is widely used by bus operators as a means of initiating and responding to competition. It brings virtually no benefits to the public, who would be better served by more regularly spaced services, particularly in off-peak periods. It has been accepted as a permissible form of competition since deregulation and Traffic Commissioners have been given no powers to regulate timing of services (except in conditions of congestion following a request from the relevant highway authority). We note that the Department of Transport's recent consultation paper (see paragraph 3.7) refers to concerns about the bunching of services by competing operators on busy routes, but only in relation to effects on road congestion.

6.31. The main method of competition on the disputed routes has been the registering of additional journeys timed before the competitor. Competition in this form against Bygone and Turners on routes 4/5, 12, 82, 85, 89, and against Mercury on the 190 group of routes and on school routes is detailed in paragraph 3.128 onwards. M&D argued that this was a justified means of competition to protect its revenue and that the extra costs of running these journeys were minimal (because the drivers and buses were spare) and more than covered by the revenue. We do not accept these arguments or that the costings arguments in themselves should determine the acceptability of a response. We accept that the timing of their services is one of the ways in which operators can justifiably compete for passengers and that an operator should have some freedom to adjust his timings if, for example, a competitor registers immediately in front of him. We distinguish M&D's behaviour, however, from the simple head-to-head registration adjusting the timing of a journey to take account of the timing of a journey offered by a competitor. In the cases we have examined M&D registered most of these additional journeys to pre-empt the feared loss of revenues to a competitor's services, some of which had been established for some time, and in fact took revenue from the competitor (see, for example, M&D's evidence on passenger journeys on route 82 (paragraph 2.48 and Appendix 2.6)). It is clear to us that the aim of these additional journeys was not to compete by offering a better service to passengers or to meet any perceived need but to remove revenue from Mercury, Bygone and Turners with the likely result that they would be forced off the routes, and that M&D had the resources to run extra journeys for this purpose.

6.32. We regard the introduction of additional journeys timed immediately before a competitor's as a step taken by M&D to maintain its monopoly position. We conclude that the practice may be expected to result in adverse effects for customers through the loss of services, and the fares offered on the routes where these are lower than those charged by M&D on the route, and the loss of potential benefits of choice and lower prices if competition had been maintained. We consider for the reasons set out above that the practice operates or may be expected to operate against the public interest.

Impeding competitors' access to bus stops

6.33. We received a number of complaints from Bygone and Turners and counter-complaints from M&D about access to bus stops in the Maidstone area. The centre of Maidstone is highly congested and there is no bus station. We received a complaint from Bygone that M&D impeded its access to stands in a private road beneath the Chequers shopping centre used by a number of operators for picking up and setting down. M&D has a travel office at the roadside and has made itself responsible for the upkeep of the poles and flags. Currently the owners do not control access or operations and since deregulation something of a free-for-all has developed, with numbers of bus and coach operators bringing in their services. We have received no complaints from other users and we do not think the evidence supports any finding against M&D. The present situation, however, is clearly unsatisfactory and we welcome information we have received from the owners that they propose to introduce improved arrangements.

6.34. There are also major departure points in the centre of the town's one-way system and operators' schedules provide for lay-overs there as well as picking up and setting down passengers. When the limited departure bays are occupied, a bus unable to get on the stand either has to circle the one-way system, which can take more than ten minutes during rush hours, or has to set down and pick up passengers in the street, bringing traffic to a halt.

6.35. Matters reached such a pitch in October 1992 that the police introduced a strict moving-on system under which no operators were allowed to take extensive stop-overs on town centre stands, even if these were provided for in their registered timetables. Matters improved somewhat but complaints have continued into 1993. M&D, with more buses on the road than its competitors, contributes most to the usage of the stands; it has, however, produced a survey it has itself carried out which shows that its competitors have longer lay-over times at the town centre stops.

6.36. The Traffic Commissioner conducted a detailed inquiry into the allegations of deliberate obstruction during the period October/November 1992, based on the results of a VIEA survey and the detailed cross-examination of witnesses. He concluded that the charge against M&D of direct interference with competitors' services was not proven. As regards allegations of continued obstruction since the start of our inquiry, M&D has denied the allegations. The limited survey in February 1993 carried out on our behalf by the VIEA (see paragraph 3.176) produced some evidence of problems caused by and for all three operators, with extended lay-overs at town centre stops blocking access for competitors. It is clear that, given the level of traffic, combined with the road arrangements in Maidstone, there is ample scope for problems to arise between operators even without any ill-will. Given the intense head-to-head competition between M&D on one hand and Bygone and Turners on the other, we think it inevitable that drivers and inspectors will have taken advantage of the conditions on some occasions to inconvenience their rivals. We do not think, however, that the evidence before us supports a finding that M&D has carried out a deliberate policy of impeding competitors' access to stops in the town centre or in the Chequers Centre.

Access to poles, flags and information cases

6.37. One operator, Bygone, has claimed that it has found difficulties in getting its flags accepted in the Chequers Centre and that its timetables have not been accepted in M&D timetable cases there. M&D told us that, after refurbishment in the Chequers Centre in late 1992, other operators' signs were inadvertently left off poles but that they were speedily replaced when the matter was drawn to its attention. M&D owns a large number of the poles on its routes. KCC complained that M&D had generally been unwilling to allow KCC or other operators to put flags or information cases on them. M&D told us that present company policy was to allow competitors to place flags and cases on its poles, on payment of an appropriate fee. We find insufficient evidence to support any finding that M&D has restricted access to its poles, flags or cases in order to maintain its monopoly position.

Provision of information

6.38. As the dominant operator in the area M&D has the largest and most widespread travel points where passengers are likely to expect to find full details available. KCC told us that until recently M&D had been unhelpful by refusing to carry KCC timetables or information about tendered services which complemented its commercial services when these were run by other operators. In addition, on a number of occasions where M&D had lost a tendered service it had issued leaflets announcing the withdrawal of the service with no indication that it would continue in other hands, and this had caused unnecessary concern to passengers. M&D told us that such an impression was inadvertent and pointed to other leaflets which it had issued over the same period referring to replacement services. It had been unwilling to carry information about other operators' services or the KCC material in case passengers held it responsible for their accuracy. Although it considered it unreasonable to be expected to carry information at travel points or in its own information cases about competing commercial services, it had agreed in November 1992 to carry information on KCC tendered services and KCC publications on bus services throughout the county where they were clearly identified as produced by KCC.

6.39. With the large number of bus operators now in the area it is clearly a great advantage to passengers to have comprehensive information on services provided by KCC and we consider that M&D, as the dominant operator, has a particular responsibility to make it available. We welcome M&D's change of policy and the assurance that it will continue to carry information provided by KCC.

6.40. While the failure to provide information about replacement services may have reflected an unhelpful attitude to competitors, the evidence made available shows that it occurred on only a handful of occasions over a period when M&D also issued numbers of acceptable leaflets and we do not think the evidence supports any finding under the Act.

6.41. While the provision of information produced by competitors about their commercial services would be of benefit to the travelling public we do not think it reasonable that M&D should be required to handle information about services actively competing against its own.

Interchangeable tickets

6.42. M&D participates with other operators in KCC's concessionary fare schemes. It also has arrangements for interchangeable tickets on certain routes and for an area-wide Explorer ticket with East Kent, Kentish Bus and South Coast Buses Ltd. Fare levels are broadly comparable and the arrangements are for the reciprocal acceptance of tickets; no payments are made between the operators. Mercury has suggested an interchangeable ticket scheme on its joint routes with M&D. M&D has pointed out that a scheme would need to be registered with the Office of Fair Trading (OFT) under restrictive practices legislation, and that it would require arrangements to recompense it at its own higher fare levels, but has not formally rejected the approach.

6.43. Arrangements for interchangeable tickets are of benefit to passengers and are normally approved by the OFT. Where such arrangements exist or the dominant operator is responsible for most of the network, exclusions from such arrangements for smaller operators can be a handicap. However, in the present circumstances we do not consider that M&D can reasonably be criticized if it refuses to enter into such arrangements on the routes on which it is directly competing with Mercury.

Other complaints

6.44. We received a number of other complaints that M&D had disadvantaged its competitors in various ways, for example by running advertising buses in colours which might be mistaken for those of a competitor. We did not consider the evidence in any of these cases sufficient to justify any finding under the Act.

M&D's fare levels

6.45. M&D operates a basic fares structure of the standard kind, linking fares to distance travelled, with a taper for increasing mileage. There are, however, departures from this structure for particular areas and routes. For example, fares in Maidstone for historical reasons are lower than elsewhere in the area, a system based on flat fares has been operated in Sittingbourne, and in a number of cases fares on indirect and direct routes to the same destinations have had to be aligned. M&D's ticketing arrangements do not allow it to record journeys in sufficient detail to construct a comprehensive index of average fare levels for comparison with other operators or to measure fares increases over time with any accuracy. There is, however, no evidence that M&D's fares as a whole are high compared with industry levels or that recent increases have been out of line with those elsewhere in the industry.

Charging reduced fares only on selected journeys

6.46. Bygone, Turners and Mercury have all entered the market with fares below those of M&D. M&D has not responded by any general price reductions on these routes. In March 1993 it had special offers on its Freedom tickets. These were spread throughout its network and we accept that they were not focused on the competition. However, M&D had earlier introduced selective price reductions on the buses running directly against competitors' buses, while leaving fares on other buses unaltered, as described in paragraphs 3.170 and 3.171. Buses offering low fares carried placards advertising the fact. M&D withdrew the selective fares reductions on 4 January 1993 but told us that revenues would be kept under review and the reductions reinstated if necessary.

M&D told us that the fares reductions were a justified competitive response in order to protect revenue, and that it had only matched, not undercut, the competitor's fares.

6.47. We consider the selective fares matching a step taken by M&D to maintain the monopoly situation. Where, as here, the dominant firm is well established with a large market share, we consider the use of this highly selective and flexible response, targeted against a competitor's attempt to enter the market, to be against the public interest in that it is likely over time to undermine the competitor's services. We find that M&D's conduct operates or may be expected to operate against the public interest.

Access to the Pentagon Bus Station

6.48. In considering the question of access to bus stations and the Pentagon Bus Station at Chatham in particular, we have noted the statement in the 1984 White Paper on deregulation that major bus stations should be operated, whether in public or private ownership, on a commercial basis under arrangements which will provide for all operators to have equal opportunity of gaining access to them. Accordingly, under the 1985 Act the scope of Restrictive Trade Practices legislation was extended to cover arrangements for the use of bus stations. This was designed to ensure that existing operators could not use their control of important bus stations to prevent other operators using them.

6.49. The Pentagon is a bus station in the centre of Chatham which is leased by M&D from Rochester upon Medway City Council under a 42-year lease, expiring in 2018. It is of unusual design; effectively it consists of a one-way double lane carriageway encircling a large shopping centre at the first floor level. The station consists of 18 bays spaced along the irregular five-sided carriageway and fully occupying one of the two lanes. Four of those bays are used for parking, as are two of the three access ramps and up to six spaces at a local car park. Two are used for other operators' long-distance and tendered services. The remainder are used for M&D's local services. Much of the carriageway is enclosed and ventilation and lighting are poor. Vehicle access is by a single ramp from a complex one-way system and there are two exits. M&D has its administrative headquarters for the area and a travel shop within the centre and is responsible for supervising all bus operations in the station.

6.50. Arguments about access to the Pentagon being refused to competitors go back over a number of years, as described more fully in paragraphs 3.199 to 3.202. On 10 December 1992 M&D agreed to allow KCC's tendered services operated by Mercury and Grey-Green Coaches to be operated from the Pentagon. Mercury began operating these services from the Pentagon on 4 January 1993. It has, however, told us that the bay allocated by M&D for other operators' tendered services (Bay 4) is inconvenient and frequently occupied by M&D buses parked there by M&D staff using M&D's cashing-up and canteen facilities.

6.51. The main M&D grounds for refusing earlier requests for access were that the bus station was already operating above capacity and that this, combined with the operating difficulties of the layout, made it impossible to accommodate further buses. M&D commissioned a report from a firm of transport consultants, which suggested that in November 1991 the station was already operating above capacity. We sought comments from a second firm of consultants, who concluded that there was in fact capacity for further departures but only at certain times. The differences between the two consultants' views have not been fully resolved; it seems clear, however, that without some adjustment of timetables or new bay arrangements there is not capacity to absorb further services, such as Mercury's competitive ones.

6.52. M&D has made clear that it considers the station to be operating already at full capacity. Its parking facilities were essential for smooth running of services and the station had been designed to include these and operational support facilities. M&D had obligations under the lease, and carried the costs of rent, administration and supervision of operations in the station. It was willing to allow access to others where they could be accommodated but would expect to have first call on bay time and saw no reason to give priority to others.

6.53. M&D also argued that access to the Pentagon is of little significance to other operators since the bus stops in Military Road and outside the Pentagon at ground level are already used by a number of services, including Mercury's commercial services, and provide an adequate alternative for passengers. Our consultant, however, advised that, while operations could be satisfactorily carried out without a bus station, where a station existed it was a significant handicap to an operator not to have access. In particular, passengers would tend to use the departure points where the dominant operator, and thus the most frequent services, on a route were located. There was also a significant proportion of passengers changing buses who would tend to use those departure points.

6.54. We do not accept that facilities outside the Pentagon are equally good. We note that there are differing expert views on whether there is spare capacity in the station at present. However, even if there is none, this does not dispose of the issue. If equal access for all operators were held to be desirable, it might be necessary in some circumstances to provide access even at the cost of ejecting some of the incumbent's operations.

6.55. M&D recently indicated that it was ready to discuss access for Mercury's commercial services and provided a copy of the conditions which would apply (see Appendix 3.4(b)). Two important conditions are that the arrangements with any operator allowed in will be terminated if the operation of its services causes M&D 'operational' difficulties and that departure charges set by M&D will be levied. M&D's current departure charges are considerably above those charged by a number of other commercial operators in the South-East and above those needed to cover an appropriate share of the costs of operating the station.

6.56. Mercury told us that it is not interested in pursuing the present offer because the departure bay offered was unsatisfactory, being the opposite side of the station from the departure bay for M&D's competing services, the departure charge was unreasonably high, and the terms and conditions would allow M&D to eject Mercury without notice if, in its view, Mercury was causing operational difficulties.

6.57. We note the criticism of M&D's terms and conditions for the use of the station. We do not consider that the provision for immediate ejection from the station if an operator causes operational difficulties is reasonable when the case is to be judged by the main competitor. While noting M&D's offer during the inquiry to renegotiate departure charges to reflect costs of operation, we consider that the present charges are at a level to put a new entrant at a disadvantage to M&D and could deter entry.

6.58. We have noted M&D's statement to us that it is prepared to discuss all these matters with Mercury, the current applicant, to try and reach a satisfactory solution. We note, however, that access has only been given to tendered services and offered to commercial services since M&D was made aware of the likelihood of the present reference. We note also that M&D made it clear in its response to us on this issue that M&D's operations must always have first call on bay space and that if Mercury's commercial services are admitted it will only be into slots left vacant by M&D's operations.

6.59. We consider that the terms and conditions under which M&D is currently offering access do not provide entrants with reasonable facilities or the security of enjoying them. Passengers consequently are denied the benefits and convenience of choice if competitive services cannot leave from the same departure point. We conclude that the failure to offer access on reasonable terms is a step taken by M&D to exploit or maintain the monopoly situation, with the adverse effects specified above, and that it operates or may be expected to operate against the public interest.

Conclusions

6.60. In the earlier paragraphs we have described the various ways in which M&D has competed in the reference area. In defending its conduct M&D emphasized the need to protect its network and revenues and claimed that, in all the cases we had examined, the additional costs to it of taking action were less than the revenue created or protected. We have explained in paragraphs 6.20 and 6.21 that we consider this approach flawed. We do not accept M&D's identification of short-term incremental costs, nor do we consider this analysis, which would

appear to justify virtually all types of immediate retaliation by an incumbent operator, an adequate basis for assessing the acceptability of M&D's competitive response.

6.61. We recognize the benefits of the M&D network of services to the reference area, and the fact that M&D has provided good-quality services and has been ready to provide services when other operators, for various reasons, have failed to operate journeys. We recognize that an incumbent operator must be free to respond to competition and to protect revenue and the benefits of his network. We think, however, that the response to competition should be fair and not designed to eliminate the competitor from the network.

6.62. In a competitive situation firms attempt to gain advantage over their rivals and to increase market share at the expense of their competitors. It is through such rivalry, with the attendant pressure to cut costs and improve efficiency, that the benefits of competition are passed on to consumers. If competition is fair, the more efficient and innovative firms are likely to prevail. The types of practices we have to consider can on the one hand be seen as normal and desirable responses to competition; on the other hand, when used by a dominant supplier, they can be seen as predatory actions designed to drive a competitor out of the market, thus denying the benefits of competition to the consumer. M&D, as the established company, has the advantages of an established network. It has the ability by selective action to target competitors which may well not have the resources to retaliate effectively in kind and may well have to withdraw from routes, thus depriving customers of the benefits deregulation was designed to bring. We have concluded that in the cases we have examined M&D was indeed trying to achieve this aim.

6.63. Against this background:

- (a) we have concluded that the running of additional journeys that do not cover their variable and semi-variable costs by M&D operates or may be expected to operate against the public interest (see paragraph 6.21);
- (b) we have identified as M&D's main method of competition its ability to target the competitor by registering additional journeys immediately before its journeys, and found that this practice operates or may be expected to operate against the public interest (see paragraph 6.32);
- (c) we have also found that three other practices—the running of unregistered buses, the registration of commercial services against competitors' tendered services, and reducing fares only on selected journeys—operate or may be expected to operate against the public interest (see paragraphs 6.24, 6.28 and 6.47); and
- (d) finally, we have found that restrictions applied by M&D to access to the Pentagon Bus Station at Chatham disadvantage competitors and operate or may be expected to operate against the public interest (see paragraph 6.59).

6.64. We have identified in paragraphs 6.21, 6.24, 6.28, 6.32, 6.47 and 6.59 certain steps taken by M&D to maintain or exploit and maintain the monopoly situation and have in those paragraphs identified adverse effects arising from these steps. We have found no actions or omissions attributable to the monopoly situation. We conclude that the steps identified above are facts found in the course of our investigation which operate or may be expected to operate against the public interest.

Recommendations

6.65. We are required by section 54(3) of the Act to consider what action (if any) should be taken for the purpose of remedying or preventing the adverse effects we have identified and we may, if we think fit, make recommendations as to such action.

6.66. M&D argued that any restraints on its freedom to react to competition would be inconsistent with the principles of deregulation in the 1985 Act. M&D pointed out that the practices we were examining were used by most other operators in the industry, including others in the reference area, and it would be unfair to penalize

them. We note, however, that the 1985 Act was intended to introduce free and fair competition and placed the industry within the scope of competition legislation. We are examining the behaviour of M&D, in whose favour we have found a monopoly situation to exist, and if we find that in the circumstances of this inquiry certain of M&D's actions are anti-competitive and against the public interest, we consider we should recommend whatever measures seem appropriate within our terms of reference.

6.67. We have found the running by M&D of additional journeys on competitive routes that do not cover variable and semi-variable costs to operate against the public interest. We therefore first considered a remedy involving the identification and regulation of such journeys. We concluded that, since allocation of costs and revenues to individual routes necessarily involves considerable judgment and some inevitably arbitrary decisions, it would be difficult for M&D to produce reliable cost and revenue estimates for individual competitive routes. For the OFT, as the regulatory body, to monitor the results across the network would make heavy demands on its resources, and those of M&D. We do not therefore make this the subject of any recommendation.

6.68. To meet the detriment we have identified arising from M&D's practice on competitive routes of introducing additional journeys immediately before a competitor's journeys we have considered two remedies in this field. The first is a limitation on the number of journeys M&D may run on a route where competition is occurring to the level at which M&D is running when the competitor enters. That frequency of service is one which, before the competitive entry, M&D considered adequate to meet consumer needs profitably. Within such a constraint it would be possible for M&D to respond to attempts by the competitor to abstract revenue by registering immediately before it, but any attempt to swamp a competitor's services with extra buses would be limited by the constraint on total numbers and at the expense of leaving the route uncovered at other times of the day.

6.69. We have also examined limitations on the timing of M&D's journeys on such routes. We considered laying down a specific interval or intervals within which M&D might not register new journeys before a competitor's service. We concluded, however, that the variety of routes and frequencies across M&D's network where competition might occur made this impracticable.

6.70. We therefore considered a more general remedy under which, on a route on which a competitor had entered or on a substantially similar route, M&D could not register a journey before a competitor's service within a shorter interval than the competitor had itself registered before an existing M&D service. Thus, if a competitor were to register an additional journey five minutes before M&D, M&D would not be able to register a journey less than five minutes before the competition; if the competitor registered ten minutes before M&D, M&D could not register less than ten minutes before the competitor, etc. We think that to be effective the remedy should apply to new registrations by M&D whether these are registrations of additional journeys or retimings of an existing service.

6.71. We considered the danger that this remedy might create an unstable situation as competitors leap-frogged one another's services. Such a remedy, however, has the advantage of also influencing the competitor's behaviour to avoid overconcentration of services. For example, if a competitor entered with timings spaced evenly between those of M&D, which is likely to provide maximum benefit to passengers, then M&D would be unable to change its registration. We concluded that the remedy was likely to encourage greater stability in timing.

6.72. We consider that the suggested remedy imposing constraints on the timing of M&D's additional journeys would be the more effective in remedying the adverse effects we have identified and the easier to implement. It has the advantage of generating some potential benefits for the travelling public by encouraging more even spacing of services and adjusts the severity of the constraint on M&D to the extent to which the new entrant targets its services against M&D's. Apart from these restrictions on timing we do not suggest any limit on M&D's ability to register new journeys or reschedule existing ones. The freedom to do so within the constraints we have suggested should help M&D to deal with some of the practical operational difficulties it foresees in the remedy, which are described below.

6.73. M&D put to us forcefully the practical difficulties that it thought might arise for it from the remedy. As M&D pointed out, if the application of the remedy was confined to routes which were directly competitive along

their whole length, eg the 82 or 89 in Maidstone or the 191 in the Chatham area, its effects could be avoided by adjusting services on closely related routes running over part of the same route or by registering new routes incorporating minor variations of existing routes. On the other hand, if limitations on timing extended to such routes M&D considered that its operations would be unreasonably constrained if it wished to make desirable changes—for example, where a number of its routes came together in a section over which a competitor ran or if it wished to introduce a new service, eg to serve a school, or to adjust services to meet other changes in demand which ran in part over a competitor's route.

6.74. Given the size of M&D's network it is not appropriate for us to try to accommodate every situation M&D has identified by laying down detailed rules. Our aim is that the remedy should apply to those of M&D commercial services which are in direct competition with those of other operators, either over the same or a substantially similar route. The intention of our remedy is clear and it would be for the OFT to consider the background in deciding whether, in the particular circumstances, M&D's registration of a service was justified. We recognize that there are difficulties in applying the remedy to a complex network of bus services and that practical problems will have to be settled. Nor do we think that the remedy will necessarily provide the complete solution to the detriments we have identified. We do, however, consider that it will act as a significant restraint on M&D's behaviour and provide some protection for new entrants against the practice which we have found to operate against the public interest.

6.75. We do not think any variation of the remedy would be needed to cover the position on existing competitive services, since other operators, if they so wished, would be able to adjust their own timings to limit the opportunities for M&D to run immediately in front of them. However, any remedy of this kind would need supporting by measures to prevent avoidance relating to duplicate services and tendered services. M&D assured us that it is not its practice to run duplicate buses except to meet non-routine passenger needs. It would be possible for M&D to retaliate against a competitor by itself entering on that competitor's own routes, either commercial or tendered. On commercial routes, the undertakings above would apply after M&D's entry to its ability to respond subsequently to any adjustment by the competitor. On tendered routes the competitor's response would be limited by the terms of the tender. We have found M&D's registration of commercial services against competitors' tendered services to operate against the public interest (see paragraph 6.28). We recommend that undertakings be sought from M&D that it will not enter on a competitor's tendered route unless it can demonstrate to the OFT that the competitor's route is in head-to-head competition with an M&D route over that part on which it enters.

6.76. We therefore recommend that the Director General of Fair Trading (DGFT) should seek undertakings to implement the remedy described in paragraph 6.70 and that such undertakings should, as may be necessary, include provision relating to tendered and duplicate services.

6.77. We are also concerned that, even if the undertakings we propose are negotiated, they may not fully remedy the effects of M&D's behaviour. We recognize that the remedy we recommend in paragraph 6.76 breaks new ground, would take time to introduce, and that its effectiveness has yet to be tested. We cannot rule out the possibility that M&D's behaviour in running additional services may contribute to other operators being forced to withdraw services, either from existing competitive routes or others established in the future. We have identified in paragraph 6.32 the potential loss of benefits to the consumer from such developments. We recommend therefore that if before undertakings are introduced M&D has introduced, or introduces, additional services running before those of the competitor on a competitive route, and the competitor then withdraws from the route, M&D, for a period of at least one year, should maintain its level of service provided on the route at the time of the withdrawal and charge no higher fares except proportionately to any general fares increase.

6.78. When such undertakings were in place we would not envisage detailed monitoring of the situation. We envisage that any monitoring would be triggered by complaints about M&D's registrations from other operators. It would be open to M&D, if uncertain about the acceptability of a proposed new registration, to consult the OFT in advance.

Since most of the demand changes to which it would want to respond should be foreseeable some months in advance this should not in most cases cause difficulties for M&D over the registration process. Any complaints

about whether M&D was properly operating its registered services would be dealt with, as now, by the Traffic Commissioner.

6.79. M&D argued that our recommendations if implemented would impose constraints on M&D which would not apply to its competitors. As the dominant operator, however, M&D has advantages in possessing a network and access to resources not shared by actual competitors or likely new entrants. If, contrary to our expectations, a competitor emerged with similar advantages or if, for example, more than one operator entered an M&D route, it would be open to M&D to seek review of its undertakings.

6.80. We have found that the running of unregistered buses by M&D operates and may be expected to operate against the public interest. Under the 1985 Act monitoring of the proper registration and operation of bus services and action against operators of unregistered buses are the responsibility of the Traffic Commissioner, who has only recently investigated complaints against M&D and taken action on those which were found to be well-founded. We therefore make no recommendations relating to this conduct.

6.81. We have also found that M&D's practice of charging reduced fares from its normal fares structure on the route, on selected journeys which directly match a competitor's timings, is against the public interest. We recommend that M&D be required to cease this practice. M&D would remain free to reduce all fares on a route if it wished to use this means of responding to a competitor.

6.82. We have also found that M&D's limitations on access to the Pentagon Bus Station at Chatham for other operators' buses operates and may be expected to operate against the public interest. We recommend that M&D should give undertakings to the OFT, first to provide all operators with equal opportunity of gaining access for their services on reasonable terms and charges, on the lines of those negotiated with Southern Vectis on access to the bus station at Newport, Isle of Wight (see Appendix 5.1), and secondly to remove from its current terms and conditions of the power summarily to eject an operator if it infringes M&D's operating conditions. We consider that such undertakings should take into account the current arrangements for tendered services and the case for moving them from Bay 4, which is prone to unauthorized parking by M&D staff. We recognize that space at the station for further commercial services is limited; we envisage that the conditions will require that, if demand for space exceeds the limited number of slots at present available, M&D will make available a further bay by rearranging and, if necessary, removing some of its own operations, possibly by surrendering a parking bay. We note in this connection that any difficulties would be considerably eased if Rochester upon Medway City Council was able to offer M&D additional parking spaces near the Pentagon.

6.83. If M&D refuses to give the undertakings suggested, or to implement them in a manner satisfactory to the OFT, we expect that the OFT will continue to monitor the situation. Should such monitoring suggest that the public interest detriments we have identified appear to be continuing, it would be open to the DGFT to consider the possibility of further action under competition legislation.

6.84. In considering these remedies, we have noted the powers exercisable under Schedule 8 to the Act. These enable Ministers to make orders to remedy certain public interest detriments identified in a monopoly report. We note that Schedule 8 does not provide order-making powers to enforce remedies of the kind we have recommended above except in relation to selective fares reductions. We urge that, in the context of the proposed measures to strengthen the existing legislation against anti-competitive behaviour announced in April 1993, consideration should be given to widening the scope of the powers.

6.85. In this inquiry, the first monopoly inquiry into a part of the UK bus industry, we have been impressed by the problems of maintaining effective competition in the reference area, where an established operator has a dominant position and is concerned to maintain the benefits of his network. Entry by a new operator may then lead

to unstable and potentially destructive competition, with little benefit to consumers. We were also concerned by the difficulties, given the nature of the industry, in framing remedies for the adverse effects we have identified from M&D's response to new entry on to its routes. While we consider that the remedies we have put forward are likely to improve the situation, we do not see them, for the reasons we have set out, as providing a complete solution.

6.86. In our earlier report on the acquisition by Stagecoach (Holdings) Ltd of Portsmouth Citybus Ltd¹ this Commission said in May 1990: 'We believe that a more general review of the bus industry may indeed be necessary given the continuing evolution in the industry's structure following the 1985 Act. This would provide an opportunity to assess the extent to which competition has asserted itself at regional and local level following deregulation.' Our experience in this inquiry has underlined the need for a searching review. One question for such a review would be the possibility of introducing effective competition through a form of franchising system, which has been applied in the television industry and is the Government's preferred route for introducing competition in the railway industry; another would be the question of whether the establishment of an 'OFBUS' regulator of the kind introduced for other utilities could lead to effective control of the adverse features we have identified.

6.87. We urge that such a review should be set in hand.

A FERRY (*Chairman*)

P BRENNAN

P A HODGSON

J S METCALFE

L PRIESTLEY

S N BURBRIDGE (*Secretary*)

14 June 1993

¹Stagecoach (Holdings) Ltd and Portsmouth Citybus Ltd: a report on the acquisition by Stagecoach (Holdings) Ltd of Portsmouth Citybus Ltd, July 1990, Cm 1130.