

# 6 Views of ARRIVA plc

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## Introduction

6.1. This chapter summarizes the views of ARRIVA given in written submissions and orally.

## Jurisdiction

6.2. ARRIVA argued that the only area affected by the merger is the borough of Luton, since Lutonian operated local bus services only in parts of that borough. Furthermore it claimed that the borough of Luton could not be regarded, either in terms of area or population, as a substantial part of the UK. Nor were there any other particular characteristics or respects in which the borough of Luton itself played such an important part in the economic development and growth and cultural life of the country that might render it special or significant.

6.3. ARRIVA further contended that even if the MMC were to conclude that the merger had effects in some or all of the reference area outside of the borough of Luton, the counties of Hertfordshire and Bedfordshire together with the borough of Luton do not form a substantial part of the UK for the purposes of the Act. Nor do they contain such urban and focal points and characteristics as could be regarded as playing an important part in the economic, social or cultural growth of the country.

## ARRIVA: evolution and development strategy

6.4. ARRIVA described how, following the original entry of Cowie into the bus market with the purchase of Grey Green Coaches Limited in 1980, it had operated scheduled bus services in London under contract to London Transport Buses, and on privatization of London Buses Limited's subsidiaries had, in 1994, acquired first Leaside Bus Company Ltd and subsequently South London Transport Limited. In February 1996 it acquired County Bus Holdings Ltd, in July 1996 North East Bus Limited, and in August 1996 British Bus. Cowie changed its name to ARRIVA in November 1997 to make it more easily identifiable in European markets and to reflect the fact that it had become a leading provider of transport services. ARRIVA the Shires is the wholly-owned subsidiary of ARRIVA which provides local bus services in Hertfordshire, Bedfordshire and Buckinghamshire, and had its

origins in LDT which was acquired as part of British Bus. ARRIVA further described the history, structure and operations of ARRIVA, as set out in paragraphs 3.17 to 3.21 and 3.30 to 3.33.

6.5. ARRIVA explained how, in line with the earlier philosophy of British Bus, the ARRIVA board set the overall vision and strategy but gave a considerable degree of autonomy to the individual operating companies. The main thrust of the strategy for bus operations in the UK was to stop and reverse patronage reduction through a shift of travellers from other transport modes. This was to be achieved by means of improvement in the quality of bus services through investment in vehicles and people.

6.6. Each operating company sought to apply that strategy in the circumstances of its own markets, and produced each year its own detailed business strategy which was reviewed by the ARRIVA main board members with responsibility for bus strategy and finance, before approval by the main group board. Decisions on local operations, including services and fares, were taken by the relevant operating company, in this case ARRIVA the Shires, which would keep the ARRIVA main board member with responsibility for bus strategy informed through a monthly review process. There were no centrally imposed criteria, though financial indicators and indicators of quality, for example in terms of percentages of scheduled mileage operated and of vehicles passing statutory inspections first time, would be monitored closely against benchmarks. There were no written guidelines on responses to competition from other operators, but the operating companies were expected to report proposed responses to the board member responsible for bus strategy.

### **Views on general bus competition and policy**

6.7. ARRIVA said that it competed vigorously with other bus operators, citing Leeds, Liverpool and Edinburgh as examples where it was seeking to expand into areas dominated by other major operators, and Strathclyde, Manchester and Merseyside as examples where other operators had sought to expand into areas where ARRIVA was already established. However, in general it sought to avoid head-to-head competition with other operators already providing an efficient service, since this was unlikely to be commercially worthwhile and, if it led to a need to report reductions in profits as a result of 'bus wars', it could lead to an adverse stock market reaction. It observed that the bus market was more stable than it was ten years ago.

6.8. ARRIVA thought smaller and medium-sized operators played a useful role where they provided a differentiated product that was wanted by the public, and ARRIVA was happy to coexist with them in that context. However, it argued that it was necessary to distinguish between those operators who were there for the long term and those who were looking to move in and then sell up. Compared with smaller operators ARRIVA enjoyed certain advantages of scale and a brand name identified with high standards, but thought that the main reason for the declining market share of smaller operators probably arose from the squeeze on public funding for such things as education contracts and concessionary fares. ARRIVA thought that the new Competition Bill, when it became law, would offer increased protection to small operators and argued that, to the extent that it helped small operators cream off lucrative routes whilst limiting the ability of larger incumbents to respond, it had potentially serious consequences for the stability of the bus industry. ARRIVA did not see that increasing use of quality partnerships or quality contracts need disadvantage smaller operators, nor require any greater regulation of the bus industry.

### **Bus services in the reference area**

6.9. ARRIVA saw Luton as average bus territory. In terms of competition with other modes of transport it was distinguished by competition from rail, due to the proximity of Leagrave station to the Marsh Farm Estate and the lack of supervision which had until recently enabled rail passengers to travel free from there into Luton.

6.10. ARRIVA advised that the strategy of ARRIVA the Shires had involved significant investment in the vehicle fleet and in marketing and training. When the current management team became responsible for ARRIVA the Shires' forerunner in 1994 there were problems over reliability of service and the quality of the network which remained similar to that at the time of deregulation. They instituted a major review of the network to simplify and improve frequency wherever possible, and introduced a

number of quality standards against which performance was monitored. They also introduced a number of higher-quality 'Sapphire' services, and aimed to bring all ARRIVA the Shires services to the Sapphire standard in due course. In the last few years there had been reasonable growth in on-bus revenue, but ARRIVA the Shires had suffered from local authority cutbacks in support of such things as student passes and concessionary schemes.

6.11. In the reference area outside Luton ARRIVA competed on commercial services with Stagecoach (United Counties), FirstGroup (Eastern National and Thamesway), and Go-Ahead (Oxford Bus and Wycombe Bus), plus a number of smaller operators including Sovereign, University Bus, Terry's Minicoaches, Red Rose, and some of the London operators in the Watford area. There had at one time been competition from TimeBus in Watford, with whom ARRIVA the Shires had coexisted amicably until TimeBus was taken over by Watford and District who made a series of aggressive registrations to which ARRIVA the Shires responded by increasing the frequency of its services. TimeBus then folded within a few days, but the competition had generated additional customers and ARRIVA the Shires has maintained its higher frequency of service. ARRIVA thought it difficult to predict whether, overall, competition was likely to increase or reduce in future, but noted the continuing expansion of University Bus. ARRIVA believed that competition in the tendered market was becoming keener as the number of potential tenderers increased.

6.12. Whilst only Lutonian provided competition to ARRIVA on routes solely within the Luton unitary authority area, there was competition on routes coming into Luton from Stagecoach, Seamarks, Sovereign and Jetlink. Prior to 1994 competition had also come from Stuart Palmer, Buffalo Travel and the original Challenger, but Stuart Palmer and the commercial local bus operations of Buffalo Travel had been acquired by British Bus and absorbed into the LDT operations, and Challenger ceased to operate commercial services in Luton. ARRIVA the Shires and its forerunners had coexisted with Lutonian for a number of years, with Lutonian concentrating on using small buses to get into estates, but competing head-to-head on the corridor routes up to those estates. ARRIVA's view was that whereas there was not room in Luton for two or more major companies to operate, there was room for small operators to coexist with a major such as ARRIVA. ARRIVA believed that there was also room for, and in fact there was, competition for tendered evening and weekend services and for school contracts, and drew attention to the recent successful entry of Red Kite into the latter market.

### **ARRIVA the Shires' Challenger services**

6.13. ARRIVA explained that the Challenger services which started in October 1997 were an experiment, designed to test the concept of a low-cost unit as a way of expanding the market, particularly in areas of Luton where the existing ARRIVA the Shires services were perceived to be weak. The experiment was based on concepts like MagicBus in Manchester and Newcastle, experience within the ARRIVA Group in areas such as Strathclyde and Northumbria, and, to a degree, Town Bus in Watford.

6.14. ARRIVA said that the idea of trialling such a service within areas of Luton had been discussed within ARRIVA the Shires for perhaps a year previously. However, driver costs at ARRIVA the Shires' Luton depot had inhibited trying this until the depot and drivers from the independent Challenger operation in Milton Keynes became available following its purchase by the new owner of Milton Keynes City Bus. The timing of ARRIVA's introduction of Challenger services in Luton was not related to Mr Dudley's plans for extending Lutonian services, of which ARRIVA had no knowledge, although Mr Dudley would have known that ARRIVA the Shires might choose to react to any such expansion.

6.15. The drivers from the Milton Keynes operation, many of whom lived in Luton, were subsequently employed by ARRIVA the Shires on the same rates of pay as they had previously received from Challenger. These were significantly below the rates paid within ARRIVA the Shires' Luton depot, although otherwise they were employed on the same terms and conditions as other ARRIVA the Shires staff. Fully depreciated vehicles of around 11 years old with an open market value of no more than £3,000 to £4,000 each were obtained from elsewhere within the ARRIVA group (Strathclyde) and were repainted in Challenger livery at a cost of around £30,000.

6.16. ARRIVA said that the routes for the Challenger services were chosen on the basis that these were the ones most likely to prove commercially successful. Lutonian had already proved to some extent that there was a market for low-cost services on those routes, Lutonian did not appear to meet

demand in some cases, and ARRIVA the Shires did not wish to try the experiment on corridors currently served entirely by itself. The area was surveyed (although the survey material could no longer be located) and a strategy and projections set out which confirmed that the idea of such an experiment on those routes was sound. Route numbering identical to that of Lutonian had been used for consistency, since ARRIVA the Shires had previously operated those service numbers in areas such as Runfold, and for simplicity to aid passenger recognition. ARRIVA had seen no need to differentiate between Lutonian and Challenger since essentially Challenger was duplicating what Lutonian was doing and the key differentiation was with the standard and Sapphire services of ARRIVA the Shires.

6.17. ARRIVA pointed out that Challenger had generated significant passenger revenue, close to projections, during the six months of its operation and that Lutonian revenues had also increased during the period. Whilst there had been some impact on other ARRIVA the Shires services, notably routes 9 and 27, this had been less than ARRIVA the Shires had anticipated, and overall the experiment had clearly generated additional bus patronage. ARRIVA claimed that it did not know whether Lutonian had itself put on extra buses or services during this period, but noted that Lutonian had not sought any new registrations.

6.18. ARRIVA stated that the Challenger fares had been set on a basis projected to generate a normal operating return of around 12 per cent within two years, and could not be regarded as predatory. The fact that the fares were at or below the levels of Lutonian fares in each case was not significant since in practice Lutonian, which did not issue tickets, did not always charge the advertised fares. Similarly, the fact that Challenger buses were scheduled to run shortly before Lutonian buses in each case was not significant in practice because Lutonian buses did not reliably operate to timetable.

6.19. ARRIVA argued that initial losses on new services were to be expected. Whilst in practice Challenger losses during the six months of the operation had been greater in percentage terms than assumed in the projections, primarily due to higher costs, the losses were very small in terms of either the Luton depot or ARRIVA the Shires as a whole. It was company practice to monitor and review performance against projections for all new services, typically initially after six months. As Challenger had ceased before its first such review, no judgment had been made on whether it was performing sufficiently well to justify its continuation.

6.20. ARRIVA said that Challenger services had been withdrawn after the acquisition of Lutonian because, as ARRIVA had acquired a low-cost operation, there was no point in replication and LBC had concerns over congestion in the town centre. ARRIVA said that as a group it did not have, or wish to acquire, a reputation for predatory pricing or unfair competitive conduct. If the aim had been to see off Lutonian or signal to other would-be new entrants or small expanding competitors that ARRIVA would compete aggressively if challenged, then it would have been in ARRIVA's interest to maintain Challenger rather than to buy Lutonian.

## **Acquisition of Lutonian**

6.21. ARRIVA stated that for a number of years its relationship with Lutonian had been fairly amicable and, in 1993, the then Managing Director of LDT had shaken hands on a deal to acquire Lutonian with Mr Dudley senior running the operation. However, Mr Dudley senior fell ill and died within six months and nothing came of this. His son, Mr Colin Dudley, had not got on with the then General Manager of Luton depot, and the relationship had cooled considerably after control of Lutonian passed to him in 1994. There had subsequently been little contact.

6.22. ARRIVA had not informed Lutonian of its intention to launch the Challenger services in advance, and the first contact had been made in October by Mr French, a retired bank manager who was acting as an adviser to Lutonian. This had led to a meeting in November 1997 between Mr Dudley and the Managing Director of ARRIVA the Shires, at which Mr Dudley had expressed considerable annoyance over Challenger operating on his routes. There followed a series of meetings and contacts involving either Mr Dudley or Mr French (of which ARRIVA said it had no records) at which, ARRIVA argued, it was unclear what Mr Dudley wanted. ARRIVA denied the allegation made to the OFT by Mr Dudley that ARRIVA had suggested that if Lutonian took off certain buses and restricted its activities in certain areas then ARRIVA would pull out of other areas beneficial to Lutonian, saying that that suggestion had come from Mr Dudley himself. ARRIVA further stated that

although the Divisional Director may during those contacts have indicated ‘tongue in cheek’ to Mr Dudley that if he had ever wanted to sell Lutonian then ARRIVA would be interested, the first substantive discussion of acquisition occurred on 9 February 1998 after Mr French had contacted the ARRIVA main board member with responsibility for bus strategy and development. At that meeting Mr Dudley had stated that he was considering selling the company and indicated a price, although it had subsequently proved difficult to establish exactly what Mr Dudley wanted. From ARRIVA’s point of view the decision to acquire Lutonian was not clear-cut given the price and likely returns, and on the other side the decision to sell appeared to be a difficult and emotional one for Mr Dudley. ARRIVA argued that it had become clear that Mr Dudley had been intending to sell Lutonian for some time, as evidenced by the fact that he transferred all his shares to his wife in November 1997 [

*Details omitted. See note on page iv.*

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## **Future plans for Lutonian and benefits of merger**

6.23. ARRIVA said that it was its intention to run Lutonian as a low-cost operation, legally and operationally separate but having the status of a depot for reporting purposes. Lutonian would have a degree of management independence, but would be financially responsible to ARRIVA the Shires and would need to agree proposed changes to services, fares etc with the management of ARRIVA the Shires.

6.24. ARRIVA had plans to extend Lutonian services, both through exploration of other areas for commercial services and possible entry into the tender market. ARRIVA was committed to maintaining the Lutonian name and operation, and had no intention, in the short term, of making changes to existing Lutonian services. Contrary to the impression gained in some quarters, the Lutonian open-ended student passes had not been withdrawn. But it could not tie itself to maintaining existing service patterns and frequencies since there might be scope for improvements or changes to the market.

6.25. ARRIVA identified a number of benefits to the public resulting from the merger. In particular it referred to: the introduction of larger and newer vehicles on Lutonian routes to meet demand; better publicity and marketing; the introduction of sophisticated ticketing machinery enabling improved understanding of passenger needs and through ticketing so that tickets bought on Lutonian services could be used on ARRIVA the Shires services and vice versa; reduction in congestion; improved timetable compliance; and greater scope for expansion in Lutonian services. ARRIVA additionally identified as benefits to employees: clearer and improved terms and conditions of employment; opportunities for union membership; improved training; and opportunities for employment elsewhere within the group. It believed that cost savings on insurance, parts and materials, fuel and purchase of vehicles were sufficient to outweigh any increases, for example in drivers’ costs.

6.26. ARRIVA acknowledged that the acquisition of Lutonian had reduced competition in Luton, but argued that it had had neither a positive nor negative effect on potential competition. It felt that since Luton was not large enough to accommodate more than one major operator, competition was more likely to come from small and medium-sized operators who developed a base within the town, but the threat of entry by neighbouring operators such as Stagecoach and Metroline remained. On fares and quality of service, ARRIVA would continue to look for organic growth and was constrained in its ability to put fares up by the availability of private cars and public perception that bus fares are expensive.

## **Remedies**

6.27. ARRIVA argued that, if the MMC were to conclude that they had jurisdiction and that the merger was against the public interest, divestment would not be an appropriate remedy because this would raise barriers to future competition by signalling to small operators considering entering a market where one operator was dominant that they would not be able to get the best price on exit by

selling to that operator. It would also have a very disruptive effect on staff and services in the lead-up to any divestment of Lutonian.

6.28. ARRIVA further argued that any requirement for undertakings that froze fares and frequencies would be against the public interest since it would limit ARRIVA's ability to respond to changes in demand. Nor did it feel that any pricing formula linked to the retail price index (RPI) would be appropriate, since the costs were not RPI-related. ARRIVA further argued that if undertakings were to run for a long period then this would call into question ARRIVA the Shires' investment strategy.

J F PICKERING (*Chairman*)

S E BROWN

R HALSTEAD

A J PRYOR

J B K RICKFORD

P A BOYS (*Secretary*)

22 October 1998