Local bus services market investigation

A report on the supply of local bus services in the UK (excluding Northern Ireland and London)

20 December 2011
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\textbf{The Competition Commission has excluded from this published version of the provisional findings report information which the Inquiry Group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by }\textit{\textsuperscript{[\texttimes]}}\textit{. Some numbers have been replaced by a range. These are shown in square brackets.}

\textsuperscript{1} Group Chairman from 30 November 2010, following Diana Guy’s retirement from the CC.
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Glossary and list of bus operators referred to in the report
Summary

1. On 7 January 2010 the Office of Fair Trading (OFT) referred local bus services to the Competition Commission (CC) for investigation and report. The reference was made under section 131 of the Enterprise Act 2002 (the 2002 Act). The OFT required the CC to confine its investigation to the effects of features of such market or markets for local bus services as exist in connection with the supply of such services in the UK excluding Northern Ireland and London (the reference area).

Overall conclusions

2. We found that head-to-head competition in the supply of local bus services was uncommon. Many local markets exhibit persistently high levels of concentration. We found that ongoing sustained head-to-head competition, where present, delivers significant benefits to customers. However, the process of competition could result in periods of intense short-lived rivalry, leading to the exit of one operator. This reduces the extent of head-to-head competition. The anticipation of costly rivalry creates a barrier to entry and expansion. Along with other barriers to entry and expansion, this reduces the competitive constraint from potential competition and new entry.

3. We also found that competition has been diminished by operator conduct leading to geographic market segregation. We have found that this conduct occurred in relation to two operators in parts of the North-East of England. This reduces the extent of head-to-head competition between operators and reduces the constraint from potential competition and new entry. Aspects of this conduct have been seen elsewhere and we remain concerned that such conduct may be more widespread.

4. We found that competition in the supply of local bus services is not effective in those local markets where head-to-head competition does not exist, and hence that there are adverse effects on competition (AECs).

5. We concluded that there were four features of local bus markets which mean that effective head-to-head competition is uncommon and which limit the effectiveness of potential competition and new entry. These features are the existence of: high levels of concentration; barriers to entry and expansion; customer conduct in deciding which bus to catch; and operator conduct by which operators avoid competing with other operators in ‘Core Territories’ (certain parts of an operator’s network which it regards as its ‘own’ territory) leading to geographic market segregation.

6. We found that, in most cases, the markets for the tendering of contracts for supported local bus services worked well. However, we found that in some cases the process of competition was impaired, and hence that there are AECs in these markets. We concluded that the number of operators bidding for Local Transport Authority (LTA) contracts and the intensity with which operators competed for these tenders could be limited by one or both of two features of the market: the way LTAs design tenders; and the limited number of potential bidders in some local areas.

7. We found that the detriment to consumers and taxpayers as a result of the AECs in the operation of local bus services (both commercial and tendered services) and the tendering of supported services was considerably in excess of £70 million a year and was likely to be between £115 million and £305 million a year.

8. We decided on a package of remedies with three main elements to address the AECs that we found. First, the remedies include market-opening measures to reduce barriers to entry and expansion, thereby reducing market concentration and providing
an environment in which competition is likely to be sustained. By reducing barriers to entry and expansion, we also expect it to become harder for operators to sustain a coordinated outcome. Second, the remedies include measures to promote competition in relation to the tendering of contracts for supported services. Third, we made recommendations about the wider policy and regulatory environment, including emphasizing compliance with and effective enforcement of competition law.

**Background to the industry**

9. The provision of local bus services is now largely in private ownership. Since the industry was deregulated in the 1980s, bus operators have been able to design and develop their own commercial services and set their own fares. However, bus operators still work within a framework of policy and regulation involving both national and local government. LTAs (of which there are 132 operating in the reference area) are responsible for setting and implementing overall strategies and policies for transport within their areas and for tendering contracts with bus operators for supported services. The licensing of bus operators and the registration of bus services outside London is the responsibility of Traffic Commissioners.

10. After several decades of steep decline, the number of passenger journeys made on local bus services has been relatively stable for the past ten years. In 2010/11, 2.9 billion passenger journeys were made on local bus services in the reference area.

11. Significant public funds go into the bus industry, although the Comprehensive Spending Review and other strategic reviews of spending will affect the public funds available for local bus services across the reference area. The main categories of spending are:

   (a) Concessionary fares. Concessionary travel schemes exist for older people and the registered disabled. Operators are reimbursed for carrying such passengers. 36 per cent of passenger journeys in 2010/11 were made by concessionary passengers; the reimbursement arrangements are intended to ensure that operators are no better or worse off than if there was no concessionary scheme.

   (b) The Bus Service Operators Grant (BSOG) is paid to all eligible operators of registered local bus services and offsets a proportion of the duty paid on fuel consumed (in Scotland BSOG is paid according to the distance operated).

   (c) Supported services. LTAs pay bus operators to provide services that would not be provided on a purely commercial basis; mostly this occurs through a tender process. In 2009/10, LTAs in the reference area spent £462 million in procuring such services and they accounted for 22 per cent of local bus mileage.

   (d) Specific local bus service funding initiatives, for example to help the development of rural bus services or to provide an incentive for the development of new services.

   (e) Capital spending on transport-related initiatives. Some are bus-specific, such as bus priority lanes or measures but other road improvement schemes can also have an impact on local buses.
Industry structure

12. There are approximately 1,245 operators running local bus services in the reference area. Since privatization, there has been a process of consolidation which has resulted in the emergence of a small number of groups with geographically extensive local bus operations. The five largest operators are Arriva, FirstGroup, Go-Ahead, National Express and Stagecoach. We refer to these as the ‘Large Operators’. They provide 69 per cent of all local bus services. Only five other operators have a share of services which exceeds 1 per cent of the reference area, and 95 per cent of all local bus services in the reference area are provided by 219 operators. Apart from the private-sector operators, there are also 11 municipally-owned operators.

13. We found that the majority of local areas are highly concentrated, with most areas being served by just one or two operators with a significant share of supply. For example, the largest operator in an Urban Area runs, on average, 69 per cent of local bus services on all routes in that area (we have identified 239 Urban Areas around cities or towns corresponding to existing networks of local bus services). However, there is substantial variation across different areas and routes. It is very uncommon for one operator’s route to overlap the route of another operator completely, and although almost every route is overlapped by the route of another operator at some point, many routes face only very limited overlap.

Policy and regulation

14. We recognized that bus policy and regulation exists to help deliver a variety of economic, social and environmental benefits. In the absence of persuasive evidence to the contrary, we found that these interventions in the market did not give rise to any prevention, restriction or distortion of competition.

15. We concluded that there was an important ongoing role for enforcement of and compliance with competition law.

16. LTAs are able to enter into partnerships with operators and can also set up ticketing schemes. We were told about the benefits of these arrangements. We were, however, very aware of the potential risks of misuse of partnerships, for example if they facilitated some degree of geographic market segregation (or similar coordination) between operators. We also urged governments to ensure that the guidance and controls in relation to the concessionary fares system were followed.

Customer demand

17. We found that customers’ choice of bus operator differed depending on whether they were planning a trip in advance or were waiting at a bus stop. We found that a substantial proportion of customers plan the bus they are going to use in advance, according to timetable, or fares, or the nature and quality of service and many would be willing to switch between operators on the basis of differences in their competitive offer. However, customers who have not already bought a particular operator’s ticket usually choose to board the first bus to their destination that arrives at the bus stop.

18. We also found that changes in the fare or service on existing services offered by local bus operators had little effect on passengers’ overall use of the bus. In conjunction with the finding that many customers would be willing to switch between operators, this indicates a substantial ‘business-stealing’ effect, where if rival operators on a route improve their offer, any increase in revenue would largely be as a result of
customers switching from other bus operators, rather than as a result of growing the overall demand for bus services.

19. Most passengers with multi-trip tickets make substantial use of these. We found that network effects can be important and that passengers will often commit to an individual operator's services through the purchase of an operator-specific multi-journey ticket.

**Market definition**

20. Customers may have a choice between alternative modes of transport to complete their journey. Many of the operators and other parties such as LTAs said that, in particular, the car was a competitive constraint on bus operators. However, the evidence did not support their view. We found that not enough passengers would switch to other modes of transport in response to small changes in the competitive variables, such as fares, for this to act as a competitive constraint which would warrant widening the relevant market.

21. Instead, the propensity of individuals to use the bus is driven more by other factors such as their income, life stage, how close their home is to a bus stop, whether the individual has access to a car and so on. Many of these factors are outside the control of bus operators. As such, whilst operators may have incentives to influence bus demand indirectly, for example by encouraging LTAs to introduce bus-favouring measures or increase parking charges, it does not give strong incentives to moderate their fares or improve other elements of their offer.

22. We found that head-to-head competition between bus operators, where it exists, forms a strong constraint. In addition, we found, that where there was a choice of alternative fixed modes of transport, such as rail and tram, bus passengers might substitute to these modes in response to small changes in bus fares. In some cases, rail and tram services may act as a competitive constraint on bus operators.

23. We found that local markets will generally be at the level of particular flows. However, competition between bus operators may occur on a number of different geographic levels including at the level of specific flows, routes or across a wider local area. The appropriate geographic area for the assessment of competition depends on the nature of the constraints faced by local bus operators. Regardless of the precise geographic boundaries of the market, we therefore assessed competition between bus operators at a number of geographic levels, including at the route and depot level. We also used Urban Areas to measure concentration and to consider the constraints of supply-side substitution from different operators.

24. We found that the market for each tender for contracts to run supported services includes all local bus operators capable of bidding for a tender. Typically this includes both tendered and commercial operators in the local area.

**Industry profitability**

25. We found that operators representing a substantial part of the market have earned profits that were persistently above the cost of capital on a national basis, indicating that competition may not have been wholly effective across the reference area. Both the annual average return on capital employed (ROCE), based on modern equivalent asset (MEA) valuations for all Large Operators, and the period average ROCE for each of these operators were above the cost of capital range throughout the period 2005/06 to 2009/10. The overall average ROCE for the five-year period of 13.5 per
cent was 3.8 percentage points above the midpoint of our cost of capital range and 2.6 percentage points above the top of the range. In addition, some of the Large Operators’ ROCEs in individual years were substantially above the top of the cost of capital range, and returns were higher at the end of the period than at the start.

**Competition in local bus services**

26. We found that there were three categories of competition between bus operators:

- **Head-to-head competition**, the constraint on operators from passengers switching to rival operators for a particular journey. This arises where operators overlap in whole or in part on their routes and compete directly. We consider that head-to-head competition is effective if it constrains the behaviour of a bus operator so that fares, frequencies and other aspects of its offer are at competitive levels. This occurs where a sufficiently large proportion of passengers would substitute to another operator in response to a reduction in the value of an operators’ competitive offer. This will depend on the proportion of passenger journeys occurring where overlaps apply, and whether customers are likely to switch (eg depending on whether rival services operate at similar times, with similar frequency, journey times and so on).

- **Potential competition**, the constraint on incumbent operators from the threat that nearby rivals might redeploy or expand their existing services and start competing head-to-head. Potential competitors are operators with existing services and facilities in or near the incumbent’s area of operation.

- **New entry**, the constraint on incumbent operators’ current behaviour from the threat that new entrants might start competing head-to-head. New entrants are operators without existing services and facilities nearby.

27. Where there is head-to-head competition on a substantial part of a route, we found that operators respond by improving the quality of their service and lowering their fares on those routes. Our econometric performance-concentration analysis in particular found a strong link between the extent of competition on a route and the total number of services run. However, we found that head-to-head competition was uncommon (see paragraph 55).

28. In many cases market structures reflect patterns of depots at privatization. We considered why concentrated market structures persist and why head-to-head competition is uncommon. Many operators told us that routes were often unable to support multiple operators. However, we found that low demand could explain the lack of head-to-head competition on only a small number of services. We have not identified any route-level economies of scale that would affect the sustainability of head-to-head competition along a route.

29. We found that there were factors in the market which tend to mean that head-to-head competition along a substantial part of the route is unlikely to be sustained. In general, bus operators compete head-to-head at least in part on the basis of service frequency. Where passengers are making their decisions at the bus stop, they are relatively insensitive to comparative fare and quality levels. Instead competition for such customers depends on operators offering more services and/or timing them to arrive shortly before their competitors’ services. Where passengers choose in advance to use a particular operator’s services or to purchase a return or network ticket, a major determinant of this choice is also the frequency of service. Since both operators have an incentive to increase the number of services they offer to attract
more passengers from their rival, oversupply on a route can occur. We found that these aspects of customer behaviour apply across the reference area.

30. As a result, competition can result in a costly period of intense rivalry between operators which is likely to be loss-making, and so culminate in the exit of one operator. This also incentivizes operators to compete in such a way as to increase the likelihood that their rival exits the route. Operators may also retaliate against entrants on some of the entrant’s other routes. We found that while such competition can be beneficial to consumers, it tends to persist only in the short term and does not necessarily result in the survival of the most efficient operator.

31. We found head-to-head competition to be less sustainable, the closer the competition between operators becomes. Therefore, operators generally avoid replicating each other’s routes too closely. When head-to-head competition is sustained, there is usually some form of differentiation between the services provided by rival operators (eg geographic differentiation so that routes only partially overlap, or offering different standards of service or fares). In other cases, there is either a sufficiently high level of demand along a route to support more than one operator providing frequent services, a degree of timetable coordination, or a smaller competitor which is not viewed as a significant threat. In the absence of the features we identify in paragraphs 47 to 49, we would expect more instances of sustained head-to-head competition.

32. We looked at the strength of the constraint from potential competition. We found that operators in certain cases take account of the actions and potential entry decisions of rivals nearby, for example by lowering the prices of network tickets and increasing the quality of their network, suggesting that potential competition can be a constraint. However, the constraint from potential competition was variable. It was restricted by barriers to expansion and so was a weaker constraint than head-to-head competition, and its strength depended on the existence and nature of possible potential competitors. We concluded that although potential competition could act as a constraint, it was not pervasive across all areas and depended on specific local circumstances.

33. The third category of constraint that we identified was new entry. We found that small-scale entry and expansion was more common than large-scale entry and expansion, and that there had been no large-scale entry in the great majority of areas in the last five years. To the extent that operators had entered new areas on a significant scale or had expanded substantially after entry, this was largely where initial entry related to tendered rather than commercial services. We found that new entry was not a strong constraint, and was likely to be a weaker constraint than potential competition.

**Barriers to entry and expansion**

34. We found that there were a number of barriers to entry and expansion in the provision of local bus services.

35. We found that the sunk costs of bringing a route to profitability are variable and uncertain but can be substantial. Related to this, there is a risk arising from the expected intensity of post-entry competition (see paragraph 30). This gives rise to potentially significant costs for the entrant, and competition is unlikely to be sustained as one or other party could be forced to exit. These risks form a barrier to entry and expansion. We recognize that the costs associated with these barriers may or may not be realized in practice. However, because a potential entrant cannot predict in advance the extent to which these costs will arise, or their size, and because these costs can be high the risks they pose can be significant. Because of this uncertainty,
these risks will apply in all cases of prospective entry and expansion in all local markets.

36. We expected the other barriers to entry and expansion that we identified to apply to varying extents. These included the possibility that, in some cases, entry gives rise to strategic retaliation from the incumbent on other routes. Operators entering with limited or relatively infrequent services may face network and ticketing barriers relative to incumbent operators. Such advantages are reinforced where multi-operator tickets are unavailable or are not well used.

37. We identified a few cases where access and charging to bus stations could restrict the ability of a new entrant to compete, particularly where an incumbent operator manages bus stations. We also found that ‘cheap exclusion’ can represent a barrier to entry (see paragraph 39). We found that, in general, access to depots was not a problem other than in a few areas where there are few suitable sites available and getting planning permission may be difficult.

Other constraints

38. We found that where head-to-head competition was absent, the behaviour of bus operators was constrained to some degree by one or more of a number of other factors. As discussed above, these could include potential competition or new entry. Other factors included the need for operators to have regard to network effects when setting fares and other aspects of their service and the need for operators to maintain good relations with the LTA and other stakeholders. We were unable to isolate the impact of each of these constraints separately, but we were able to understand their collective strength. There was evidence that these factors in combination constrain the behaviour of local bus operators, to some extent, when they do not face head-to-head competition. As a consequence, the detrimental effect on customers as a result of the AECs we have found is smaller than it might be in the absence of these constraints. However, these other constraints are insufficient to prevent an AEC from arising altogether.

Exclusionary conduct

39. We found that there were some aspects of competitive conduct which were undertaken to diminish a rival’s ability to offer its service but which delivered no benefit to customers. We term this category of conduct ‘cheap’ exclusion. Examples of ‘cheap’ exclusion include obstruction of a rival’s services, for example through deliberately blocking or delaying their services on the road, preventing them from using bus stops and stands, intimidating drivers, causing damage to a rival’s vehicles, depots or other facilities, removing rival operators’ publicity and timetables, providing misinformation about a rival’s services to passengers, imitating a rival (such as copying its livery), or guiding passengers at a bus stop away from boarding a rival’s services. Cheap exclusion restricts head-to-head competition and the constraint from potential competition and new entry. We found that, despite it being to some extent subject to the powers of the Traffic Commissioners and other legal constraints, incidents of cheap exclusion are still observed.

Operator conduct and geographic market segregation

40. We found, in relation to two operators (Arriva and Go-Ahead) in parts of the North-East of England, conduct by which they avoided competition in Core Territories, leading to geographic market segregation. Where this behaviour arises, it means that operators concentrate on serving their own territories while declining to challenge
rivals in the latter’s areas, and anticipating that they are then less likely to be chal-

lenged by these rivals in their own Core Territories. This behaviour is reinforced by retaliatory arising in the event of an operator entering against an incumbent. This conduct may include some or all of: retaliation and signalling; extensive communica-
tion between operators at various levels of seniority about their respective commer-
cial operations; and the sale/acquisition of rivals’ assets. These behaviours will reduce or eliminate head-to-head competition and diminish the constraint from poten-
tial competition.

41. We have seen retaliatory conduct in several areas, and consideration of retaliation elsewhere, as well as other aspects of the operator conduct listed in paragraph 40. Although our finding was limited to parts of the North-East, in conjunction with the finding that the conditions to facilitate coordination apply in the bus industry, we were concerned that geographic market segregation might be a more widespread feature than we have identified.

42. We have been troubled by inaccuracies in the representations provided to us in our investigation of geographic market segregation. This has led to concerns over the reliability and completeness of parties’ representations and the weight that can be attached to them.

**Competition in the tendering of supported services**

43. We found that competition in the tendering of supported services depends on a variety of factors, including the anticipated profitability and risk of the contract. We found that operators’ expectations of the number of operators that would bid was an important factor in how they decided to pitch their bids. Where there were a limited number of operators in a local area, fewer bids were received.

44. We also found that an LTA’s design of tenders and the tendering process could reduce the intensity with which operators compete in setting their bids, and/or dis-
suade operators from bidding. We identified a number of aspects of tender design which could have the effect of reducing competition for tendered contracts, such as the use of short contract periods, not offering an option between minimum-subsidy and minimum-cost contracts, not providing all relevant information to bidders and procurement practices including how procurement directives are interpreted and applied.

45. We concluded that the markets for tendering of supported services works well in most instances, and we recognize that there were often good reasons for LTAs adopting a certain approach to the design of a contract, but we found that in certain local markets, competition for tendered services is prevented, restricted or distorted.

**Supply of local bus services—features and findings**

46. We found that competition in the markets for the supply of local bus services is pre-
vented, restricted or distorted where a combination of the features identified below has an adverse effect on competition.

47. The first feature is the existence of a high level of concentration in each relevant market. This refers to the extent of overlap between operators’ services causing high concentration at the level of passenger flows. For an AEC to arise in a relevant market, effective head-to-head competition has to be absent. High concentration can also refer to the limited presence of operators across a wider local area, but this is not a necessary condition for the feature to arise. In such cases, this indicates that
the constraint from potential competition will be reduced, adding to the impact of the AEC.

48. The second feature is the existence of barriers to entry and expansion (see paragraphs 35 to 37).

49. The third feature is how customers conduct themselves in deciding which bus to catch. There are two aspects of customer conduct. First, some customers commit to a particular operator by purchasing a single-operator multi-journey ticket. Second, customers place a high value on time saved and certainty, relative to other factors such as price or quality. This means that customers who are not already committed to an operator prefer to catch the first available bus when at the bus stop and to minimize waiting time (regardless of any differences in relative fares and service quality between operators).

50. The fourth feature is operator conduct, by which operators avoid competing with other operators in Core Territories, leading to geographic market segregation. We have found that this conduct applies in relation to two operators in parts of the North-East of England.

51. We have found that combinations of these features prevent, restrict or distort competition in two ways as described below.

52. The first way in which AECs arise derives from the first three features in paragraphs 47 to 49. If a flow is highly concentrated, an operator will not face effective head-to-head competition against its services. In addition, the constraints from potential competition and new entry are restricted by the barriers to entry and expansion that we have identified. Potential competition may also be further weakened if the wider local market is highly concentrated. Customer conduct contributes to this outcome in that competition can take forms as described in paragraphs 29 and 30. This creates or reinforces barriers to entry and expansion, and may be a cause of high concentration. In the absence of these market features, we would expect that local bus operators would compete such that there was more head-to-head competition on a route or on flows, and/or the threat of potential competition and new entry would act as a stronger constraint.

53. In addition to the first three features, we have found a fourth feature to be present in parts of the North-East of England, relating to the conduct of Arriva and Go-Ahead (see paragraph 50). This also gives rise to an AEC in a further way. Where all four features apply, geographic market segregation has diminished head-to-head competition and so caused high market concentration. This conduct also reduces the strength of potential competition, as the parties concerned are less likely to enter in head-to-head competition with existing services than they otherwise would. This prevention, restriction or distortion of competition also requires barriers to entry and expansion to be present, as otherwise this geographic market segregation could be undermined by new entry or expansion.

Presence and extent of adverse effects

54. We considered where AECs, as described in paragraph 52, can arise in local markets. Given that customers behave as described in paragraph 49, and there are barriers to entry and expansion in every market, we found that competition is prevented, restricted or distorted in any market which is highly concentrated.

55. We used a route-based analysis to identify the markets which are concentrated and therefore where we found an AEC, as it was not practicable to analyse each flow
individually. Although almost all routes in the reference area faced some overlap from a rival operator, we found that effective head-to-head competition, across the reference area, is uncommon. We found that 46 per cent of routes, accounting for 63 per cent of services in the reference area, do not face effective head-to-head competition. Only 3 per cent of routes, accounting for 1 per cent of weekly services, are likely to face effective head-to-head competition. For the remaining routes, a lack of flow-level information prevented us drawing firm conclusions on the extent to which they faced head-to-head competition. Nevertheless, the extent of overlap faced by these routes suggested that, at least in a substantial number of cases, a large proportion of passengers on these routes were unlikely to have a choice of operator.

56. We found just eight out of 239 Urban Areas where more than 10 per cent of services were on routes where all flows were likely to face effective head-to-head competition from a rival local bus service. For a substantial proportion of routes in many Urban Areas, we were unable to determine whether or not they faced effective competition, although our analysis of the extent of overlap faced by these routes—as well as some of the conservative assumptions that we used—suggested that many of the flows on these routes would be subject to an AEC. Overall we concluded that across the reference area as a whole and in the majority of Urban Areas, a significant number of routes were highly likely to be subject to an AEC.

57. This assessment takes account of a number of factors in addition to the degree of head-to-head competition on a route. First, we identify some routes where it is possible that there is competition from a rail or tram service. Second, we account for instances where we might not necessarily expect that services would face competition, absent the features which lead to an AEC. This includes routes that might be served by a single vehicle, and supported services where we would not normally expect there to be opportunities for a viable commercial service.

58. We found that the AEC in relation to operator conduct leading to geographic market segregation was present in parts of the North-East of England.

**Tendering of supported services—features and findings**

59. We found that competition in the market for the tendering of supported local bus services is prevented, restricted or distorted because the number of operators bidding for the tender contract and the intensity with which operators compete for these tenders is limited by one or both of the following features:

(a) the way LTAs design tenders; and

(b) the limited number of potential bidders in local areas.

**Conclusion on the AECs and features**

60. We therefore concluded, on the statutory question that we have to decide pursuant to section 134(1) of the 2002 Act, that there are AECs within the meaning of section 134(2) of the 2002 Act.

**Detrimental effects**

61. We found that detrimental effects arose where consumers had little or no choice of bus operator and there was limited competitive pressure from operators that might begin competing head-to-head. In these areas (see paragraphs 54 to 58), incumbent bus operators were able to reduce the quality of service they offered to customers, or
increase fares above the level that would otherwise apply. We found that the detrimental effects in relation to competition for the tendering of supported services (see paragraph 59) were reduced choice and innovation, higher costs and/or reduced quality of service.

62. Overall, we found that the detriment to consumers and taxpayers as a result of the AECs that we found in the operation of local bus services (both commercial and tendered services) and the tendering of supported services, is considerably in excess of £70 million a year and is likely to fall within the range of £115 million to £305 million a year.

Remedies

63. We decided on a remedy package with three main elements: market-opening measures in relation to commercial bus services; measures to promote competition in relation to supported services; and recommendations about the wider policy and regulatory environment.

64. The three market-opening measures are aimed at reducing barriers to entry and expansion and thereby reducing high concentration in markets for commercial bus services and providing an environment in which competition is likely to be sustained. These measures are:

(a) Ticketing: recommendations to give LTAs additional powers to determine the characteristics of mandatory multi-operator ticketing schemes and for the OFT to review certain aspects of the competition law framework governing voluntary ticketing schemes. Final decisions about ticketing schemes will be taken locally in line with the principles we have set out. This remedy will directly address incumbency advantages arising from network and ticketing effects (see paragraph 36).

(b) Operator behaviour: recommendations for restrictions on changes in service frequency through increased registration notice periods and changes to frequent service registrations. We also recommend that Traffic Commissioners be given the powers to introduce and enforce a local bus operator Code of Conduct and that there should be restrictions around the sale of municipal bus companies. This will help to address the barriers to entry and expansion associated with expectations of post-entry competition and cheap exclusion (see paragraphs 35 and 38).

(c) Access to bus stations: an Order requiring local bus operators that manage bus stations to provide access to bus stations for rival operators on fair, reasonable and non-discriminatory terms and to publish the Conditions of Use, which contains, among other things, information about charges and the allocation of stand and layover capacity. This will enable third party operators to compete on a level playing field and give confidence to potential entrants that their entry plans are not at risk due to difficulties in securing access to bus stations.

65. We decided on the following measures in relation to supported services:

(a) Best practice guidance: recommendations that the Department for Transport (DfT) update its best practice guidance on tendering for supported services for LTAs, and that the Scottish and Welsh Governments develop similar but suitably tailored guidance. This will reduce the risk that tenders are specified in ways that restrict competition.
(b) Information about newly deregistered services: recommendations that LTAs are given powers to obtain, and where appropriate disclose, information about revenue and patronage of services being deregistered. This will enhance LTAs’ ability to specify and manage the tenders to promote competitive outcomes and reduce the risk of competition being restricted by incumbency advantages.

66. In support of the above measures, we decided to make the following recommendations for changes to the wider regulatory and policy environment which applies to bus markets:

(a) Effective competition enforcement and compliance: recommendations that the OFT applies a high priority to identifying bus mergers between competing operators, routinely follows up bus mergers and takes a cautious approach in exercising its discretion not to refer small bus mergers to the CC. We also recommend that the OFT publishes revised Frequently Asked Questions about the application of competition law to the bus industry. Vigilant merger control is necessary to prevent further increases in market concentration. We therefore see a key role for the CC and OFT to enforce competition law to address the AEC and limit the scope for further increases in market concentration. We expect that, following publication of this report, local bus operators will review their competition compliance training, making use of the guidance available to them, and impress upon their employees that rigorous competition compliance is an important part of the culture of their organization.

(b) Partnerships: a recommendation that LTAs consider the potential for tailoring partnerships to facilitate increased competition within their local areas. However, we are also mindful of the risks of misuse of partnerships and the importance of proper scrutiny of their effects on competition. We therefore also recommend that the OFT establishes a regular forum with operators to discuss issues relating to the competition assessment of partnership arrangements with LTAs and other stakeholders.

(c) BSOG: a recommendation that as part of its current review of BSOG in England, the DfT considers ways of incentivizing the development of, and participation in, a number of the remedies we are proposing. This recommendation may also be of interest to the Scottish and Welsh Governments.

67. These remedies will also have the effect of making it harder for operators to sustain a coordinated outcome and will reduce the incentive to coordinate.

68. We concluded that the above measures, taken together as a package, would be effective and proportionate in remedying the AECs. We expect this remedy package to be fully implemented with a substantial impact on the AECs and customer detriment within three to six years of publication of our final report, although we also expect significant beneficial effects to arise earlier.

69. We decided not to recommend the introduction of franchising either instead of or alongside our other measures. We concluded that, compared with the possible introduction of franchising, our remedy package directly addresses the AECs, is at least as effective in addressing the associated customer detriment and is less costly and therefore provides a more proportionate solution. However, we recognize that there is existing legislation enabling LTAs to introduce franchising in England, Scotland and Wales and we would not wish to rule out its future application in particular local markets where the respective legislative requirements are met. We also note that LTAs have wider social and policy objectives that are not relevant to this investigation, but which may legitimately lead them to take a different view on the desirability
of introducing franchising in relation to the local bus markets for which they are accountable.

70. We concluded that this package of measures represents as comprehensive a solution as is reasonable and practicable to the AECs and resulting customer detriment that we found.
Findings

1. The reference

1.1 On 7 January 2010 the OFT referred the supply of local bus services to the CC for investigation and report. The reference was made under section 131 of the 2002 Act. In accordance with section 133(2) and (3)(a) of the 2002 Act, the OFT required the CC to confine its investigation to the effects of features of such market or markets for local bus services as exist in connection with the supply of such services in the UK excluding Northern Ireland and London.¹

1.2 The terms of reference for our investigation are set out in Appendix 1.1.

1.3 Our inquiry is a market investigation under the 2002 Act. Section 134(1) of the 2002 Act requires us to decide whether ‘any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom’. If the CC decides that there is such a feature or combination of features, there is said to be an AEC.²

1.4 Under section 131(2) of the 2002 Act, a ‘feature’ of the market refers to:

- the structure of the market concerned or any aspect of that structure;
- any conduct (whether or not in the market concerned) of one or more than one person who supplies or acquires goods or services in the market concerned; or
- any conduct relating to the market concerned of customers of any person who supplies or acquires goods or services.

1.5 If the CC finds that there is an AEC, it is required under section 134(4) of the 2002 Act to decide whether action should be taken by it, or whether it should recommend the taking of action by others, for the purpose of remedying, mitigating or preventing the AEC, or any detrimental effect on customers³ so far as it has resulted from, or may be expected to result from, the AEC; and, if so, what action should be taken and what is to be remedied, mitigated or prevented. The 2002 Act requires the CC ‘to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any detrimental effects on customers so far as resulting from the AEC’ (section 134(6)). In considering remedies, the CC may take into account any relevant customer benefits, as defined in the 2002 Act, arising from the feature or features of the market (section 134(7)).

Background to the reference

1.6 Since the deregulation of the bus industry in 1986 (outside London and Northern Ireland), local bus services have increasingly been, and are now, largely provided by private bus operators as either commercial services or supported services funded by

¹ Defined by section 137 of the Transport Act 1985 as the administrative area of Greater London as for the time being constituted.
² See section 134(2) of the Act.
³ A detrimental effect on customers is defined in section 134(5) of the Act as one taking the form of:
   (a) higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
   (b) less innovation in relation to such goods or services.
LTAs and other similar bodies. Some services are provided by municipally-owned operators and not-for-profit organizations (such as local community groups).

1.7 On 5 March 2009, the OFT announced that it would conduct a market study into local bus services. The OFT decided to undertake this market study because information it had received from various sources—including complaints about alleged predatory and other exclusionary behaviour, data about market performance obtained during its mergers work and data about the costs of procuring supported services—had prompted it to ask whether local bus services worked well for customers. The information received by the OFT related to the local markets outside London and Northern Ireland. In conducting its market study, the OFT examined the situations in London and Northern Ireland and spoke to stakeholders in those areas, but it did not identify any issues of concern in either of them. Therefore its market study focused on local bus services markets in the UK excluding London and Northern Ireland.

1.8 On 20 August 2009 the OFT announced its proposed decision to refer the market for the supply of local bus services in the UK excluding London and Northern Ireland (the ‘reference area’) to the CC for a market investigation and published a document for consultation. On 7 January 2010 the OFT confirmed its decision to make a reference to the CC.

1.9 In its decision to refer, the OFT reported that it had found evidence that limited competition between bus operators tended to result in higher prices and lower quality for bus users and may represent poor value for money for taxpayers. The study identified a number of features of local bus markets that it reasonably suspected adversely affect competition relating both to commercial services and services subsidized by LTAs. The OFT’s decision found that issues of concern included:

- many routes only served by a single operator;
- large regions tend to become dominated by a particular operator that supplies most of the services;
- the concessionary fare regime may distort the market by creating an incentive for bus operators to raise fares;
- allegations of targeted competition designed to eliminate competitors without providing any long-term benefit to consumers;
- incumbent bus operators with a well-developed network may have little incentive to enter into multi-ticketing arrangements;
- bus users’ conduct has an impact on how bus operators compete with each other;
- some areas receive low numbers of bids for supported services; and
- evidence that in areas where only one of the large national groups offers services, fares for commercial services are higher than in areas where two or more of the national groups operate.

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4 ‘Local bus services: The OFT’s reasons for making a market investigation reference to the Competition Commission’ January 2010, paragraph 2.5. This document is available on the OFT’s website at: www.oft.gov.uk/shared_ofr/reports/transport/OFT1158_Local_bus_services.pdf.
7 In paragraphs 1.13–1.21.
Conduct of the investigation

1.10 In this section we set out an overview of the key stages of our investigation and provide an understanding of how we used the evidence we received. During the investigation we published a considerable number of papers on the CC website. These include non-confidential versions of parties’ written submissions and summaries of hearings, as well as our issues statements, working papers, and the results of a number of surveys, studies and analyses. Further details can be found in Appendix 1.1, Annex A.

1.11 We have been careful to ensure that our processes have been both thorough and fair throughout our investigation. We have had regard to the CC’s published guidelines on market investigations\(^8\) and other published guidance\(^9\).

From reference to provisional findings

1.12 We began our market investigation into local bus services following the reference from the OFT on 7 January 2010. We published an issues statement on 4 February 2010 based on the terms of reference and the initial information and evidence we had received. On 17 March 2010 we published a notice setting out how we intended to gather information from bus operators.

1.13 Following receipt of further evidence, on 10 September 2010 we published an updated issues statement. We published a series of working papers between September 2010 and February 2011.

1.14 The updated issues statement and working papers took account of submissions from parties in response to the initial issues statement, responses to questionnaires and evidence provided in hearings with the main parties (bus operators) and third parties.

1.15 We published our provisional findings in full on 10 May 2011. As we had provisionally concluded that an AEC was present we also published a Notice of Possible Remedies on 6 May 2011. Following late receipt of further evidence, we subsequently published our provisional findings on tacit coordination (published 4 August 2011) and an addendum to our provisional findings addressing geographic market segregation and operator conduct (published 1 November 2011).

From provisional findings to final report

1.16 Following the publication of our provisional findings and Notice of Possible Remedies we received submissions from interested parties in response to them and held response hearings with a number of parties. We also published an update to our performance-concentration analysis on 6 October 2011 and a working paper on route and area analysis on 12 October 2011.

1.17 Further to our Notice of Possible Remedies, we gathered additional evidence from parties, conducted further analysis (details of which are set out in Appendix 1.1, Annex A) and published our provisional decision on remedies on 6 October 2011\(^{10}\).

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\(^{10}\) On 25 November 2011 we published an erratum relating to the calculation of customer detriment in Appendix A of our provisional decision on remedies.
1.18 We received a number of further responses from parties in response to our provisional decision on remedies and the two working papers noted in paragraph 1.16, which have been taken into consideration in this report. Further details can be found in Appendix 1.1, Annex A.

Report overview

1.19 This document, together with its appendices, constitutes our final report which sets out our findings based on our analysis of the evidence received during the course of the investigation. It refers, where appropriate, to material published separately on the CC website. The report, however, is self-contained and is designed to provide all material necessary for an understanding of our findings.

1.20 The remainder of this report is set out as follows:

- Section 2 describes the background to the local bus industry, including relevant policy frameworks and regulation of the industry.
- Section 3 provides some background detail on a number of bus operating companies.
- Section 4 describes the structure of the local bus industry, the geographic distribution of areas of operation of different operators, and the extent of overlap between their services.
- Section 5 considers demand and customer behaviour.
- Section 6 explores the nature of competition between bus operators and between bus operators and other modes of transport.
- Section 7 considers market definition for local bus services, and for the tendering of supported services.
- Section 8 sets out our analyses of the process of head-to-head competition between bus operators, the constraints from potential competition and new entry, and geographic market segregation and operator conduct.
- Section 9 considers barriers to entry and expansion, and whether or not any barriers impact on the constraint from expansion and potential competition.
- Section 10 sets out our assessment of the profitability of local bus operators.
- Section 11 sets out our analysis and assessment of competition in the provision of local bus services.
- Section 12 sets out our consideration of the effects on competition of bus policy and regulation.
- Section 13 describes our analysis and assessment of competition for the tendering of supported services.
- Section 14 presents our conclusions in relation to the statutory questions that we are required to answer.
- Section 15 sets out our decisions in relation to remedies and the reasons for those decisions.
2. **Industry background**

*Introduction*

2.1 A local bus service is defined in the Transport Act 1985 (the 1985 Act). Broadly, it is a bus service using one or several public service vehicles to carry passengers at separate fares where the distance between stopping places or overall journey length is less than 15 miles (24 kms) as the crow flies. This definition includes a number of 'non-standard' local bus services,¹ which we are not specifically addressing throughout this report, as explained in Appendix 2.1.

2.2 The framework within which the supply of local bus services in Great Britain has developed in recent years was set by the 1985 Act. For the previous 50 years, the level of service provision on every bus route in Great Britain had been controlled by Traffic Commissioners, and since 1968 the vast majority of local bus operations had been in public ownership. Under the 1985 Act, local bus services were to be provided commercially, with direct public support being confined to services which the local authority deemed to be socially necessary. The 1985 Act set in train a process which started with the deregulation of the industry in October 1986 and involved both the progressive privatization of most local bus operations in Great Britain outside of London and their consolidation in a rapid succession of mergers and acquisitions.

2.4 The provision of local bus services is now largely in private ownership. Since the industry was deregulated in the 1980s, bus operators have been able to design and develop their own commercial services and set their own fares. However, bus operators still work within a framework of regulation involving both national and local government, which includes the requirement for all bus services to be registered with the Traffic Commissioner. Significant amounts of public money continue to flow into the industry through fuel rebates, concessionary fare schemes (giving free or discounted travel to eligible passengers) and the procurement of supported services² (where LTAs (see paragraphs 2.69 to 2.74) pay bus operators to provide services that would not be provided on a purely commercial basis). It should be noted that all public funding is currently subject to review by the Government. Recently, LTAs have played an increasing role in influencing bus services through their own local policies and through schemes, both voluntary and statutory, under which they can enter into arrangements with local bus operators.

2.5 After several decades of steep decline, the number of passenger journeys made on local bus services has been relatively stable for the past ten years. The level of supply, measured in terms of the number of vehicle kilometres operated, broadly followed the same declining trend as demand until 1986, but then increased significantly for the following ten years. The overall level of supply has been stable for the past ten years.

2.6 Throughout this section, the focus is on the investigation’s reference area, ie the UK excluding London and Northern Ireland. This section considers in turn:

(a) the trends in the demand and supply of local bus services (see paragraphs 2.7 to 2.17);

(b) the development of the industry (see paragraphs 2.18 to 2.42);

¹ For example, coach services, where the route taken involves sections with less than 15-mile gaps between stops, demand-responsive services; or bus substitution (rail replacement) services.

² Throughout this section, the term ‘supported services’ refers to all bus services procured by LTAs, the majority of which are procured through a tendering process. The DfT uses the term ‘supported’ to refer to these services in its statistics.
Market size and trends

2.7 The total demand for travel, increased by a compound annual growth rate (CAGR) of 2 per cent between 1980 and 2007. This growth was driven by car travel. The demand for bus and coach travel by contrast declined between 1980 and 1992, but has since then been growing again. By 2007, the demand for bus and coach travel was, however, still marginally lower than in 1980, as shown by Table 2.1.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cars, vans and taxis</th>
<th>Buses and coaches</th>
<th>Rail</th>
<th>Other*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>388</td>
<td>52</td>
<td>35</td>
<td>16</td>
<td>491</td>
</tr>
<tr>
<td>1985</td>
<td>441</td>
<td>49</td>
<td>36</td>
<td>18</td>
<td>543</td>
</tr>
<tr>
<td>1990</td>
<td>588</td>
<td>46</td>
<td>40</td>
<td>16</td>
<td>690</td>
</tr>
<tr>
<td>1995</td>
<td>618</td>
<td>43</td>
<td>37</td>
<td>14</td>
<td>712</td>
</tr>
<tr>
<td>2000</td>
<td>640</td>
<td>47</td>
<td>47</td>
<td>17</td>
<td>749</td>
</tr>
<tr>
<td>2005</td>
<td>674</td>
<td>48</td>
<td>52</td>
<td>20</td>
<td>794</td>
</tr>
<tr>
<td>2007</td>
<td>685</td>
<td>50</td>
<td>59</td>
<td>20</td>
<td>813</td>
</tr>
</tbody>
</table>

27-year CAGR (%) 2 0 2 1 2

Source: Adapted from Tables 2.1a and 2.1b of the Department for Transport (DfT) Transport Trends 2009 editions.

*Includes: air, motorcycle and pedal cycle.

2.8 In 2010/11, 2.9 billion passenger journeys were made on local bus services in the reference area, of which 36 per cent were accounted for by concessionary passengers as shown by Table 2.2. The number of journeys made by concessionary passengers increased by 8 per cent to 1,032 million in 2010/11 from 955 million in 2007/08. Concessionary passengers represent a higher proportion (43 per cent) of passengers in Wales.

<table>
<thead>
<tr>
<th>Area</th>
<th>Fare-paying passengers</th>
<th>Concessionary passengers*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>English metropolitan areas</td>
<td>679</td>
<td>376 (36%)</td>
<td>1,055</td>
</tr>
<tr>
<td>English non-metropolitan areas</td>
<td>826</td>
<td>458 (36%)</td>
<td>1,284</td>
</tr>
<tr>
<td>Scotland</td>
<td>289</td>
<td>149 (34%)</td>
<td>438</td>
</tr>
<tr>
<td>Wales</td>
<td>64</td>
<td>49 (43%)</td>
<td>113</td>
</tr>
<tr>
<td>Total reference area</td>
<td>1,858</td>
<td>1,032 (36%)</td>
<td>2,890</td>
</tr>
</tbody>
</table>

Source: DfT Annual Bus Statistics, Great Britain, 2010/11 Table BUS0103, Table BUS0105.

*Proportion of passenger journeys accounted for by concessionary passengers is indicated in brackets.

2.9 As shown in Table 2.3, 481 million vehicle kilometres or 23 per cent of local bus services in the reference area are currently supported. The extent of such supported

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3 There are three concessionary fare schemes in place in each of the nations in the reference area, under which certain categories of passengers are entitled to free travel. These are described in more detail in Appendix 12.3.
services varies significantly by area: over one-third of services are supported in Wales, compared with 16 per cent in English metropolitan areas.

TABLE 2.3  Vehicle kilometres provided for local bus services in the reference area in 2010/11

<table>
<thead>
<tr>
<th></th>
<th>Commercial</th>
<th>Supported*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>English metropolitan areas</td>
<td>473</td>
<td>88 (16%)</td>
<td>561</td>
</tr>
<tr>
<td>English non-metropolitan areas</td>
<td>792</td>
<td>280 (26%)</td>
<td>1,072</td>
</tr>
<tr>
<td>Scotland</td>
<td>285</td>
<td>69 (19%)</td>
<td>354</td>
</tr>
<tr>
<td>Wales</td>
<td>79</td>
<td>43 (35%)</td>
<td>122</td>
</tr>
<tr>
<td>Total reference area</td>
<td>1,629</td>
<td>481 (23%)</td>
<td>2,110</td>
</tr>
</tbody>
</table>

*Proportion of total kilometres accounted for by supported services is indicated in brackets.

Source: DfT Annual Bus Statistics, Great Britain, 2010/11 Table BUS0205b.

2.10 The proportion of bus services that are supported has increased from 17 per cent at the time of privatization. This change was driven by a 16 per cent (or 305 million vehicle kilometres) decrease in the number of kilometres provided commercially since 1999/2000, a proportion (109 million vehicle kilometres) of which was subsequently procured by local authorities. We note, however, that the number of kilometres provided commercially across the whole of the reference area declined by only 5 per cent from 1,718 million to 1,629 million between 1987/88 and 2010/11, as shown in Figure 2.1.
2.11 The number of passenger journeys on local bus services in the reference area has declined by nearly 60 per cent over the last 40 years, although the downward trend has stabilized since 1996/97. Until the deregulation of the industry in October 1986, the supply of local bus services, as measured by vehicle kilometres, had also declined. Following deregulation, supply increased sharply back to its 1970 level by 1994/95. It has since then decreased but still remains marginally above the level of supply at the time of deregulation. Figure 2.2 shows the long-term trends in vehicle kilometres operated and passenger journeys undertaken.
2.12 Figure 2.3 shows that following privatization, the total distance travelled by local buses in commercial service rose more sharply in the English metropolitan areas than in any other area type in the reference area. Although it has since declined, it remains close to the level of supply at the time of privatization, despite a very sharp decline in passenger journeys. With the exception of English metropolitan areas, where the supply of supported services has declined, the number of supported services has risen sharply\(^4\) in recent years, in response to operators’ deregistration of commercial services.

\(^4\) This increase is, however, from a low base.
FIGURE 2.3

Passenger journeys and annual vehicle kilometres on local bus services by area type and service type in the reference area 1987/88 to 2001/11, indexed to 1987/88

(a) English metropolitan areas
(b) English non-metropolitan areas
(c) Scotland
(d) Wales

Source: DfT Annual Bus Statistics 2010/11, CC analysis.
*The DfT changed its methodology in 2004/05. We have shown the figures under both the old methodology and the new one, hence the time series show the year 2004/05 twice.

2.13 The cost of operating local bus services rose by an average of 5.1 per cent per year over the past five years, as shown by Table 2.4.
TABLE 2.4 Operating costs generated by local bus services in the reference area

<table>
<thead>
<tr>
<th>Year</th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>English metropolitan areas</td>
</tr>
<tr>
<td>2004/05</td>
<td>858</td>
</tr>
<tr>
<td>2005/06</td>
<td>925</td>
</tr>
<tr>
<td>2006/07</td>
<td>1,046</td>
</tr>
<tr>
<td>2007/08</td>
<td>1,052</td>
</tr>
<tr>
<td>2008/09</td>
<td>1,071</td>
</tr>
<tr>
<td>2009/10</td>
<td>1,131</td>
</tr>
<tr>
<td>2010/11</td>
<td>1,130</td>
</tr>
</tbody>
</table>

6-year CAGR* (%) 4.7 5.4 5.2 4.6 5.1

Source: DfT Annual Bus Statistics, Great Britain, 2010/11 Table BUS0406a (based on operator survey information), CC analysis.

*CAGR = Compound Annual Growth Rate.

Note: The DfT noted that its figures were based on a sample survey and therefore results based on smaller samples may be less reliable than those based on larger samples.

2.14 The growth in the operating revenue generated on local bus services was broadly in line with the rise in costs, albeit slightly higher with a CAGR of 5.5 per cent, as shown by Table 2.5.

TABLE 2.5 Operating revenue derived from local bus services in the reference area

<table>
<thead>
<tr>
<th>Year</th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>English metropolitan areas</td>
</tr>
<tr>
<td>2004/05</td>
<td>1,068</td>
</tr>
<tr>
<td>2005/06</td>
<td>1,103</td>
</tr>
<tr>
<td>2006/07</td>
<td>1,141</td>
</tr>
<tr>
<td>2007/08</td>
<td>1,191</td>
</tr>
<tr>
<td>2008/09</td>
<td>1,240</td>
</tr>
<tr>
<td>2009/10</td>
<td>1,268</td>
</tr>
<tr>
<td>2010/11</td>
<td>1,332</td>
</tr>
</tbody>
</table>

6-year CAGR (%) 3.8 6.8 5.0 4.9 5.5

Source: DfT Annual Bus Statistics, Great Britain, 2010/11 Tables BUS0401a and BUS0501a (based on operator survey data and administrative data), CC analysis.

2.15 Between 2005/06 and 2010/11, the average age of the operators’ bus fleets in the reference area decreased from 8.8 years to 8.4 years, as shown by Table 2.6.

TABLE 2.6 Average age of the bus fleet used by area type

<table>
<thead>
<tr>
<th>Year</th>
<th>£ million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>English metropolitan areas</td>
</tr>
<tr>
<td>2005/06</td>
<td>8.4</td>
</tr>
<tr>
<td>2006/07</td>
<td>8.1</td>
</tr>
<tr>
<td>2007/08</td>
<td>7.7</td>
</tr>
<tr>
<td>2008/09</td>
<td>7.7</td>
</tr>
<tr>
<td>2009/10</td>
<td>7.7</td>
</tr>
<tr>
<td>2010/11</td>
<td>7.9</td>
</tr>
</tbody>
</table>

Source: DfT Annual Bus Statistics, Great Britain, 20010/11 Tables BUS0602 and BUS0605, CC analysis.

2.16 Table 2.7 sets out recent developments in fares for different areas between 1995 and 2010. The greatest fare increases have been experienced in English metropolitan areas, the lowest in Scotland. For comparison, we also include the retail prices index (RPI). In Table 2.8, price indices for transport are shown, derived from elements contributing to the calculation of the RPI, between 1999 and 2009. This shows that
whereas the cost to consumers of all private motoring has fallen substantially in real terms, rail fares have increased in real terms, but bus and coach travel has increased in cost more substantially in real terms, i.e., the cost of coach and bus travel has increased relative to other modes of transport in this period. These price increases over the last decade are consistent with the longer-term trends in use of modes of transport set out in Table 2.1. However, passenger kms travelled by bus have increased over the last ten years.

### TABLE 2.7  Local bus fares index (not adjusted for inflation) in the reference area, 1995 to 2011

<table>
<thead>
<tr>
<th>Year</th>
<th>English metropolitan areas</th>
<th>English non-metropolitan areas</th>
<th>Scotland</th>
<th>Wales</th>
<th>All items RPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>61.8</td>
<td>61.8</td>
<td>70.2</td>
<td>63.5</td>
<td>77.4</td>
</tr>
<tr>
<td>1996</td>
<td>65.2</td>
<td>64.7</td>
<td>72.4</td>
<td>64.5</td>
<td>79.5</td>
</tr>
<tr>
<td>1997</td>
<td>69.0</td>
<td>67.9</td>
<td>77.8</td>
<td>67.2</td>
<td>81.6</td>
</tr>
<tr>
<td>1998</td>
<td>72.6</td>
<td>71.4</td>
<td>84.1</td>
<td>71.8</td>
<td>84.4</td>
</tr>
<tr>
<td>1999</td>
<td>75.8</td>
<td>74.9</td>
<td>87.5</td>
<td>75.3</td>
<td>86.1</td>
</tr>
<tr>
<td>2000</td>
<td>79.1</td>
<td>78.4</td>
<td>89.6</td>
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</tr>
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<td>2001</td>
<td>83.3</td>
<td>82.7</td>
<td>92.2</td>
<td>84.7</td>
<td>90.4</td>
</tr>
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<td>2002</td>
<td>87.3</td>
<td>86.6</td>
<td>93.5</td>
<td>88.6</td>
<td>91.6</td>
</tr>
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<td>2003</td>
<td>90.3</td>
<td>90.8</td>
<td>96.1</td>
<td>91.6</td>
<td>94.4</td>
</tr>
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<td>94.7</td>
<td>95.3</td>
<td>97.1</td>
<td>95.8</td>
<td>96.9</td>
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<td>100.0</td>
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<td>105.1</td>
<td>105.0</td>
<td>102.4</td>
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<td>2007</td>
<td>113.6</td>
<td>102.0</td>
<td>111.4</td>
<td>111.5</td>
<td>107.3</td>
</tr>
<tr>
<td>2008</td>
<td>121.6</td>
<td>106.7</td>
<td>116.7</td>
<td>117.5</td>
<td>111.3</td>
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<td>2009</td>
<td>136.5</td>
<td>113.9</td>
<td>126.5</td>
<td>125.3</td>
<td>110.3</td>
</tr>
<tr>
<td>2010</td>
<td>137.6</td>
<td>115.6</td>
<td>129.5</td>
<td>128.7</td>
<td>115.9</td>
</tr>
<tr>
<td>2011</td>
<td>146.4</td>
<td>119.4</td>
<td>132.2</td>
<td>130.1</td>
<td>122.0</td>
</tr>
</tbody>
</table>


*Index as at March.

### TABLE 2.8  RPI: transport components Great Britain, 1999 to 2009

<table>
<thead>
<tr>
<th>Year</th>
<th>All items RPI</th>
<th>All motor* RPI</th>
<th>Rail fares RPI</th>
<th>Bus &amp; coach fares RPI</th>
</tr>
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<tbody>
<tr>
<td>1999</td>
<td>100.0</td>
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<td>103.8</td>
<td>101.7</td>
<td>104.0</td>
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<td>103.3</td>
<td>105.6</td>
<td>108.4</td>
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<td>2002</td>
<td>106.5</td>
<td>102.5</td>
<td>108.1</td>
<td>111.7</td>
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<tr>
<td>2003</td>
<td>109.6</td>
<td>103.8</td>
<td>109.9</td>
<td>116.4</td>
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<tr>
<td>2004</td>
<td>112.9</td>
<td>104.8</td>
<td>114.1</td>
<td>122.4</td>
</tr>
<tr>
<td>2005</td>
<td>116.1</td>
<td>105.5</td>
<td>118.7</td>
<td>130.5</td>
</tr>
<tr>
<td>2006</td>
<td>119.8</td>
<td>107.0</td>
<td>123.4</td>
<td>132.3</td>
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<tr>
<td>2007</td>
<td>124.9</td>
<td>108.4</td>
<td>129.8</td>
<td>139.8</td>
</tr>
<tr>
<td>2008</td>
<td>129.9</td>
<td>111.7</td>
<td>135.4</td>
<td>148.5</td>
</tr>
<tr>
<td>2009</td>
<td>129.2</td>
<td>110.9</td>
<td>142.6</td>
<td>157.5</td>
</tr>
</tbody>
</table>

Source: DfT Transport Statistics Great Britain Table TSGB0120.

*The RPI all motor index includes purchase of a vehicle, maintenance, petrol and oil and tax and insurance. See Notes and definitions for further details.

2.17 The Confederation of Passenger Transport (see paragraph 2.82) has compiled a bus and coach industry cost index since 2003. The index tracks movements in operators’ key costs and combines them to give an overall figure for changes, using figures supplied by volunteer member companies in each region. In Table 2.9 we present this index for the UK. Whilst this index includes London and Northern Ireland, as well as coaching activities, and therefore does not fully reflect the reference market it can be compared with changes in the bus and coaches component of the RPI as shown
in Table 2.8 to see how recent fare changes have corresponded to changes in operator costs. In the early part of the comparison the fare index lagged behind the reported increases in costs, but more recently fare increases have been slightly higher than cost increases.

<table>
<thead>
<tr>
<th></th>
<th>CPT cost index</th>
<th>RPI bus &amp; coach fares</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>7.8</td>
<td>5.2</td>
</tr>
<tr>
<td>2005</td>
<td>8.2</td>
<td>6.6</td>
</tr>
<tr>
<td>2006</td>
<td>7.1</td>
<td>1.4</td>
</tr>
<tr>
<td>2007</td>
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<td>5.7</td>
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<tr>
<td>2008</td>
<td>5.7</td>
<td>6.2</td>
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<tr>
<td>2009</td>
<td>5.0</td>
<td>6.1</td>
</tr>
<tr>
<td>2010</td>
<td>1.7</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: CPT website, CC calculations on RPI derived from Table 2.8.

Note: N/A = not available.

**The development of the industry**

**The historical context: 1900 to 1985**

2.18 Motorized road public transport systems, including buses and tramways, were put in place in the first two decades of the 20th century and grew rapidly in the 1920s. During this period, local bus services were provided by an increasing number of large and small private operators, local authorities and pre-existing businesses with interests in other types of transport, ie the Tilling Group (horse-drawn carriages), the British Electric Traction Company (BET) (tramways), and the four railway companies (Great Western Railway, Southern Railway, London, Midland and Scottish Railway and North Eastern Railway). BET and the Tilling Group grew to be the two largest bus groupings in the UK. What was to become the largest bus operator in Scotland, the Scottish Motor Traction Company (SMT), was founded in 1905.

2.19 According to historical research by John Hibbs, the bus operators’ pattern of expansion resulted in the creation of bus operating territories: as they grew, operators tended to expand from their initial bases along high-demand routes until they had created a network of services and a monopoly position in a given area, from which they would often expand into a neighbouring area, thus establishing a larger operational territory. During the 1920s, a number of operators, in particular BET’s subsidiaries, the Tilling Group, the larger independent operators and latterly the railway operators, put in place bilateral agreements, which formally defined the boundaries around their respective and distinct territories of operation. Parties to these agreements thus committed not to compete with each other. Over the same period, over 90 local authorities set up local bus operations which were often protected by their owners’ refusal to issue licences to potential competitors.

2.20 This period was not devoid of competition, as small independent operations were set up by entrepreneurs seeking to capitalize on fast-growing demand: the number of operators grew from 331 in 1916 to 3,962 by 1930. As they sought to grow their business, these operators sometimes competed head-to-head with each other or with

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the larger operators. Episodes of intense competition, involving leapfrogging and very low promotional fares, were reported. Concerns over safety, unscheduled and irregular services run by independent operators and perceived unnecessary service duplication caused by competition between buses and other types of transport (railways, trams/trolleybuses) led to the Road Traffic Act 1930 (the 1930 Act), which, among other innovations, introduced regulations on vehicle fitness and drivers’ working hours. It also introduced a route licensing system for the bus industry that was to remain largely unchanged until the early 1980s. Under this system, Traffic Commissioners would license routes and regulate fares based on a number of criteria including the following:

(a) on the basis of ‘the extent, if any, to which the needs of the proposed routes are already served’;8

(b) ‘to stop wasteful competition’;9 and

(c) on the basis of ‘the needs of the area as a whole … (including … the provision of unremunerative services)’10.

The changes brought by the 1930 Act led to the consolidation of bus operations into territorial monopolies in the 1930s. By 1939, BET, Tilling and SMT controlled over two-fifths of buses in Great Britain. After the Second World War, the Tilling and SMT groups’ bus operations were nationalized. Their bus interests later became part of the Transport Holding Company (THC), which was intended to act as a commercial enterprise. BET and independent operators remained outside government control although British Railways, as successor to the ‘big four’ private railway operators, retained significant shareholdings in BET companies. In 1967, BET agreed to sell its bus operations to the THC.

2.22 The Transport Act 1968 (the 1968 Act) brought significant changes to both the municipal sector and the government-owned operations.

2.23 The 1968 Act created regional authorities called Passenger Transport Authorities (PTAs), which were responsible for all passenger transport services in their respective areas. They delegated the day-to-day management of bus operations to Passenger Transport Executives (PTEs), which were also responsible for local rail networks. There were originally four PTEs: Merseyside, Tyneside, West Midlands and Greater Manchester (the latter becoming South East Lancashire and North East Cheshire, or SELNEC in 1969). In 1974, three additional PTEs were created: Greater Glasgow, South Yorkshire and West Yorkshire,11 and the other PTEs expanded to cover the areas of the new Metropolitan counties. Most PTEs subsidized fare levels.

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6 The process by which two competing operators engage in headrunning, ie running their bus service directly ahead of the other operator’s service on the same route, in order to collect the passengers who are waiting for the other operator’s bus service. Leapfrogging results in several changes to timetables in quick succession. It can also create situations where rival operators ‘race’ and overtake each other on the road to try to be the first to reach busy bus stops.

7 For example, the episode of ‘bitter’ competition between Crossville Motor Services and Hudson’s Bus that lasted from August 1920 to January 1922. This is referred to in John Hibbs, The History of British Bus Services, 1989, p82.

8 Section 72(3)(a) Road Traffic Act 1930.

9 Section 72(4)(b) Road Traffic Act 1930.

10 Section 72(3)(d) Road Traffic Act 1930.

11 Under the Local Transport Act 2008, the six PTAs in England were renamed Integrated Transport Authorities (ITAs). The current successor bodies to the seven PTEs created between 1968 and 1974 are GMPT (Greater Manchester), Merseytravel (Merseyside PTE), Travel South Yorkshire (South Yorkshire PTE), Nexus (Tyne and Wear PTE), Centro (West Midlands PTE), Metro (West Yorkshire PTE) and the Strathclyde Partnership for Transport. On 1 April 2011, GMPT was renamed Transport for Greater Manchester (TfGM) and will carry out GMPT’s current role along with a range of other transport-related functions.
The 1968 Act reorganized the THC’s bus interests into two state-owned bodies: the Scottish Bus Group (SBG),\(^{12}\) responsible for bus operations in Scotland, and the National Bus Company (NBC), responsible for England and Wales. Both the SBG and NBC operated through territorial subsidiary companies. In 1970, NBC acquired the former country area buses of London Transport and some other provincial operations, while conversely it sold urban operations in Greater Manchester and the West Midlands to the PTEs.

By the early 1980s, NBC had a 44 per cent share of the market, with the municipal sector, including PTEs accounting for another 38 per cent—see Table 2.10.

### TABLE 2.10 Local bus vehicle kilometres by type of operator, 1982

<table>
<thead>
<tr>
<th>Share</th>
<th>Million</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>NBC</td>
<td>821</td>
<td>44</td>
</tr>
<tr>
<td>7 PTEs</td>
<td>474</td>
<td>26</td>
</tr>
<tr>
<td>49 Municipal Operators</td>
<td>222</td>
<td>12</td>
</tr>
<tr>
<td>SBG</td>
<td>169</td>
<td>9</td>
</tr>
<tr>
<td>Private operators</td>
<td>163</td>
<td>9</td>
</tr>
<tr>
<td>Total</td>
<td>1,849</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Adapted from Table 6 of the Buses White Paper 1984.

NBC’s locally-managed subsidiary companies retained their own fleet names and liveries, although NBC sought to introduce a national identity with corporate liveries introduced from 1972. In NBC’s early years there was some rationalization, which led to the amalgamation of operating subsidiaries into larger units and the transfer of areas between them. Some operations were passed to the PTEs. Thus the number of operating subsidiaries shrank from 72 in 1969 to 37 by 1978. However, this trend was reversed in the late 1970s and 1980s when NBC and SBG undertook the Market Analysis Project with a view to putting their businesses on a more commercial footing. Following this review, which included studying local demand, local area identities were introduced and several larger NBC subsidiaries were split up.

The privatization process

In July 1984, the Government published Buses (the 1984 White Paper),\(^{13}\) a white paper setting out its proposals for deregulating and privatizing local bus services in England, Scotland and Wales. The central hypothesis of the 1984 White Paper was that a deregulated market for local bus services would be highly contestable. Incumbent firms would be forced to behave efficiently if they wished to prevent or deter competition. If incumbents behaved efficiently, they could survive and even expand, but only by the efficient production of the right product mix at the right set of prices with the right technology. The 1984 White Paper also made the following predictions about the future of the industry:

(a) cost efficiency would improve;

(b) cross-subsidy would be reduced, though there may be some ‘commercial cross-subsidy’;

(c) on many services passengers would pay lower fares;

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\(^{12}\) SBG was part of the Scottish Transport Group.

\(^{13}\) Buses, Cmnd 9300, Department of Transport, Scottish Office, Welsh Office.
(d) standard fares across local networks would cease to exist;

(e) predation should not occur (due to the high contestability of the market);

(f) innovation and differentiated services would be a much stronger feature of the industry; and

(g) patronage should rise.

2.28 The 1985 Act enacted the proposals set out in the 1984 White Paper and introduced the following major changes:

(a) It removed Traffic Commissioners’ powers to control operators’ entry into and exit from the local bus market provided operators met the licensing requirements and maintained their fleets to the required standard.

(b) It required NBC to draw up a programme for the disposal of the entire undertaking as small free-standing units. The main objective was to promote sustained and fair competition, both between NBC’s subsidiaries and between them and other bus companies. NBC was also required to have regard to the net value that might be secured from all disposals and to give all employees a reasonable opportunity of acquiring a controlling interest in that part of the organization for which they worked.

(c) It reformed PTA and local authority local bus operations by establishing arm’s-length limited companies (though without specific reference to privatization). Both PTE and municipal companies would stand on their own feet as discrete private companies, but their shares could still be owned by the local authority. They would compete with other operators for passengers and for contracts to run subsidized services.

(d) It commercialized public sector bus provision in Scotland through the ‘corporatization’ of municipal and PTA operations, but without requiring privatization.

2.29 The deregulation of local bus services came into force on 26 October 1986. Industry commentators noted that following deregulation, there was a significant level of competition in the large urban areas, with 26 operators registering services in West Yorkshire and around 40 in Greater Manchester, but that the effect of deregulation was less pronounced in other areas. Only seven already established operators registered services in Tyne and Wear. According to the same source, there was little competition in the West Midlands, the main local operator having a very good and well-established range of travelcards and a very comprehensive network. In Glasgow, several operators registered new services ahead of the deregulation date and oversupply resulted in significant congestion.14

2.30 An early academic study15 of local bus services competition in free-standing conurbations, cities or towns with at least a population of 40,000 (of which there were 149 in Great Britain, excluding London) found that during the first two years of deregulation, there was active on-the-road competition affecting at least two main routes in 44 of these areas. Every urban area had experienced some form of minor competition. The nature of the competitive interactions has been described as ‘service wars with fares matching’. The role of price leader was usually taken by the incumbent,

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14 Buses Focus, 10 years of deregulation, Autumn 1996.
with entrants matching its prices. Service competition involved aggressive driving behaviours such as ‘headrunning, racing to stops, holding back and turning round’. Although the extent to which incumbents could deny access to bus stations was restricted by provisions in the 1985 Act and the subsequent OFT decision regarding access to Newport (Isle of Wight) bus station, the authors of the academic study noted that it was common for entrant firms to be refused access to canteen/office facilities at bus stations, for information points to be manned solely by the incumbent firm’s staff (who gave either no information or mis-information about the entrant firm’s services) and for entrant firms to be located in the least attractive stands in the bus station and at some distance from the incumbent firm’s rival services. Other practices described included stand blocking, extended layover periods on stands or the herding of customers away from the rival’s services. There were also instances of operators seeking to increase their rivals’ costs, for example by withholding surplus buses from the second-hand market and recruiting a rival’s staff by offering slightly better terms and conditions. It was noted that ‘fare wars’ had been less common and that fare competition had been focused on branded ticketing such as network tickets, return tickets, multi-journey tickets or discount vouchers. The authors perceived that the main innovation had been the use of minibuses by operators.

Privatization of NBC

2.31 In May 1986, NBC submitted its disposal programme. In addition to the restructuring that had taken place in the early 1980s, further NBC companies were forcibly broken up and, as shown in Figure 2.4, 52 local bus operating companies were put up for sale at privatization.17

FIGURE 2.4
Bus operating subsidiaries of NBC at the time of privatization

21. United Counties 27. South Wales / De Cymru 42. The Beeline 43. Alder Valley South
31. South Midland 37. Southern National 52. East Kent
32. Badgerline 38. Wills & Dorset
33. Bristol 39. Hampshire Bus
34. Western National 40. Southern Vectis
35. North Devon (Red Bus) 41. Provincial
36. Devon General 42. The Beeline
37. Southern National 43. Alder Valley South
38. Wills & Dorset 44. Southdown
40. Southern Vectis 46. London Country North West
41. Provincial 47. London Country North East
42. The Beeline 48. London Country South West
43. Alder Valley South 49. Kentish Bus
44. Southdown 50. Hastings & District
45. Brighton & Hove Bus and Coach Company 51. Maidstone & District
46. London Country North West 52. East Kent


17 There were 72 subsidiaries put up for sale, including coach operating and engineering companies, but because a number of these were sold together there were 52 separate sales.
2.32 The disposal of NBC took place between July 1986 and 1988. In order to preserve competition, it was stipulated that no single purchaser would be permitted to buy more than three major subsidiaries. Companies would not be permitted to buy geographically contiguous subsidiaries in order to prevent large tracts of territory coming under the same ownership and potentially stifling competition.\textsuperscript{18} Although a number of trade buyers bought more than one subsidiary, the quotas set by the Government were respected. Thirty-six of the 52 sales were to employee or management teams.

Privatization of SBG

2.33 SBG was reorganized in 1985 so that its operating companies’ territories were aligned with regional council boundaries. Its privatization was enacted by the Transport (Scotland) Act 1989, which required the Secretary of State to promote sustained and fair competition both between the privatized SBG companies and between them and other bus operators. Following further restructuring, the sale of SBG took place between August 1990 and October 1991. Four out of the nine bus operations (shown in Figure 2.5) were sold to management and employee buyout teams.

\textsuperscript{18} Although the restriction on purchases of bus companies and subsidiaries was not maintained following the privatization process.
There was no legislation mandating the sale of municipally-owned bus operations, and it has been argued\(^\text{19}\) that the pressure to sell came from interested buyers and the poor financial state of some operations. The local authority sector was privatized on a piecemeal basis, with 28 operations sold between 1988 and 1996, some as ‘distress sales’ whilst in administration (eg Barrow Borough Transport, Darlington Transport and Lancaster City Transport, all of which were purchased by Stagecoach) and a further six operations sold between 2005 and 2009. All eight PTE operations were initially sold to management and employee buyouts. Thirteen municipally-owned operations were sold to management and employee buyouts and 21 to trade sale buyers. Although Nottingham City Transport Ltd (NCT) remains in council ownership, Transdev plc (Transdev) holds 18 per cent of its shares.

\(^{19}\text{See Charles Roberts (2003), Analysis of the effects of ownership change on the British bus industry since 1986 (available at www.staff.livjm.ac.uk/etmcrobe/thesis/).}\)
Overall timeline of the bus industry privatization

2.35 Table 2.11 summarizes the process of privatization of the local bus industry.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1984</td>
<td>Publication of White Paper—Buses</td>
</tr>
<tr>
<td>1985</td>
<td>Transport Act 1985</td>
</tr>
<tr>
<td>July 1986–Oct 1988</td>
<td>Mandated sale of the 52 operating companies of the NBC</td>
</tr>
<tr>
<td>January 1988</td>
<td>Government announcement of its intention to privatize SBG</td>
</tr>
<tr>
<td>1989</td>
<td>Transport (Scotland) Act 1989</td>
</tr>
<tr>
<td>August 1990–October 1991</td>
<td>Mandated sale of the 9 operating companies of SBG</td>
</tr>
<tr>
<td>June 1988–December 1996</td>
<td>Voluntary sale of 28 PTE and municipally-owned bus operations</td>
</tr>
<tr>
<td>2005–2009</td>
<td>Voluntary sale of a further six municipally-owned operations</td>
</tr>
</tbody>
</table>

Source: CC analysis of various public sources of information.

Development of the industry since privatization

The process of consolidation

2.36 Since the privatization of the NBC between 1986 and 1988, we have identified well over 300 mergers and acquisitions of local bus operators in the reference area, with an average of 13.5 transactions per year taking place between 1988 and 2009.\(^{20}\) There was a particularly high number of mergers in both the late 1980s (as the management- and employee-owned operations were sold on to trade buyers) and mid-1990s (which corresponded with the period when the large groups were floated and many municipal operations were privatized).

2.37 Figure 2.6 shows the number of mergers and acquisitions in the reference area from 1988 to 2009 based on our analysis.\(^{21}\)

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\(^{20}\) We recognize that this may not be a complete total and that there may be many more.

\(^{21}\) Excludes transactions which were blocked by the competition authorities or resulted in the divestment of the entirety of the acquired party.
2.38 We asked the OFT for details of those cases which it had records of investigating over the same period and this is given in Table 2.12 below.\textsuperscript{22}

\begin{table}[h]
\centering
\caption{Regulatory review of sample of local bus merger cases}
\begin{tabular}{ll}
\hline
\textbf{Status} & \textbf{Number} \\
\hline
OFT investigated and decision reached & 117 \\
Of which: & \\
Clear\vspace{-2pt}ed & 65 \\
Found not to qualify & 28 \\
Undertakings in lieu & 2 \\
Favourable confidential guidance & 1 \\
Referred to CC/MMC and not proceeded with & 3 \\
Referred to CC/MMC and cleared & 8 \\
Referred to CC/MMC and SLC found & 10 \\
\hline
\end{tabular}
\end{table}

\begin{flushright}
\textsuperscript{22} We recognized that the information was not complete given the time that had elapsed. We also did not have any information about why any merger was not investigated and the merger intelligence that this was based on. There could be a number of reasons for this, including that it was found not to qualify for investigation at an early stage or that there was no credible theory of harm.
\end{flushright}

2.39 The information showed that there has been a significant degree of regulatory review of mergers in the industry. Many were cleared at the first stage of merger investigation but in over half of the cases further referred to the CC/MMC and investigated there was an adverse finding.
The process of consolidation, which resulted in the emergence of a small number of groups with geographically extensive local bus operations, involved three parallel strands:

(a) The progressive amalgamation of the NBC and SBG subsidiaries. By 2006, the 52 former NBC companies were in the hands of seven companies, as shown by Figure 2.7: Arriva plc (Arriva), Stagecoach Group plc (Stagecoach), FirstGroup plc (FirstGroup), Go-Ahead plc (Go-Ahead), Transdev, East Yorkshire Motor Services Group (EYMS) and Wellglade Ltd (Wellglade). In Scotland, the nine former SBG companies were acquired by Stagecoach (Northern, Highland, Strathtay and Western Clydeside), Arriva (Clydeside 2000) and FirstGroup (Midland, Eastern, Lowland and Kelvin Central).

(b) The purchase of PTE and municipally-owned subsidiaries by trade buyers with interests in the former NBC and SBG subsidiaries. All the former municipal operations that had been sold to their employees/management were acquired by trade buyers between 1989 and 2001. All former PTE operations were sold to their current owners as single entities, as shown in Table 2.13, with the exception of Greater Manchester Buses, which was split in two before privatization, and Merseyside Transport, which was sold to its management and employees but subsequently sold to Arriva (the sale to Arriva was the subject of an OFT investigation which required Arriva to dispose of a depot).

Table 2.13 Acquisition of the former PTE operations by trade buyers

<table>
<thead>
<tr>
<th>Operation</th>
<th>Buyer</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yorkshire Rider (West Yorkshire)</td>
<td>FirstGroup</td>
<td>1994</td>
</tr>
<tr>
<td>Busways (Tyne and Wear)</td>
<td>Stagecoach</td>
<td>1994</td>
</tr>
<tr>
<td>West Midlands Travel</td>
<td>National Express</td>
<td>1995</td>
</tr>
<tr>
<td>Strathclyde Buses</td>
<td>FirstGroup</td>
<td>1996</td>
</tr>
<tr>
<td>GM Buses North (Greater Manchester)</td>
<td>FirstGroup</td>
<td>1996</td>
</tr>
<tr>
<td>GM Buses South (Greater Manchester)</td>
<td>Stagecoach</td>
<td>1996</td>
</tr>
<tr>
<td>Mainline (South Yorkshire Travel)</td>
<td>FirstGroup</td>
<td>1998</td>
</tr>
<tr>
<td>Merseyside Transport Limited (MTL)</td>
<td>Arriva</td>
<td>2000</td>
</tr>
<tr>
<td>Glenvale (formerly MTL’s Gilmore depot)</td>
<td>Stagecoach</td>
<td>2005</td>
</tr>
</tbody>
</table>

Source: Extracted from TAS Bus Monitor 2009.

(c) Acquisition of companies which had always been in the private sector. There have been numerous such transactions, many of which were extremely small and almost always involved former competitors of the acquiring company. As noted in Table 2.10, at the time of the 1984 White Paper, private operators had a 9 per cent share of the local bus kilometres operated in the reference area.

The privatization of NBC and SBG preceded that of the municipal sector by several years. Some commentators have noted that due to the inefficiencies they had inherited and lack of market experience, these companies were vulnerable to competition from the NBC/SBG groups, which had already restructured and improved their efficiency. Barrow Borough Transport, Lancaster City Transport and Boro’line Maidstone have been quoted as examples of distress sales caused by a period of intense competition from a large operator. Referring to these cases, commentators noted that weaknesses in the local municipal operator, sometimes caused simply by

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23 The exception is Preston Bus Limited which remained in employee ownership until 2009, when it was purchased by Stagecoach. It was sold to Rotala plc (Rotala) in January 2011.
the announcement that the controlling council had decided to sell the company, led to ‘the local major operator moving in over all its routes and putting it out of business’.\textsuperscript{24}

2.42 Figure 2.7 illustrates the outcome of the process of consolidation of the NBC companies. This is based on the map produced at the time of privatization and does not purport to show the precise boundaries of operators’ networks.

FIGURE 2.7

The current ownership of the former NBC units

Source: TAS Bus monitor 2009, CC analysis.

\textsuperscript{24} Buses Focus, Autumn 1996, ‘10 years of Deregulation’.
The operators currently active in the reference area and the location of their networks

Local bus operators

2.43 There are approximately 1,245 operators running local bus services in the reference area. 269 per cent of local bus services in the reference area (after weighting for total frequency) are provided by five operators and 95 per cent by 219 operators. Only ten operators have a share of frequency-weighted local bus services which exceeds 1 per cent of the reference area as a whole. Figure 2.8 shows the cumulative shares of frequency-weighted local bus services across all operators in the reference area, ordered by size.

FIGURE 2.8
Cumulative shares of the 1,245 operators of local bus services in the reference area

Source: CC analysis of Traveline data for October 2009.
Notes:
1. A log scale is used on the X-axis.
2. Share of total frequency refers to the number of weekly services on all routes run by an operator, divided by the total number of weekly services on all local bus routes run by all operators in the reference area. The total weekly bus services run by an operator refers to the total number of buses scheduled to travel on an operator’s routes in the course of a week.

2.44 The suppliers of local bus services can be divided into three different categories:

(a) Large UK transport groups, which run at least 100,000 local bus services per week in the reference area. There are five operators falling within this category:

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26 The figures in this paragraph have been derived using the Traveline database of local bus routes in the reference area as of October 2009. More details on this database and how it has been prepared can be found in Appendix 4.1.
Arriva, FirstGroup, Go-Ahead, National Express plc (National Express) and Stagecoach. We refer to these as the Large Operators.

(b) Operators owned by local authorities, of which there are 11: Ipswich Buses Limited, NCT, Halton Borough Transport Limited, Warrington Borough Transport, Blackpool Transport Services (Blackpool Transport), Rossendale Transport Ltd, Reading Transport Ltd (Reading Transport), Thamesdown Transport Ltd, Cardiff City Transport Services Ltd (Cardiff Bus), Newport Transport and Lothian Buses plc (Lothian Buses). We refer to these as the Municipal Operators.

(c) Independent operators, the largest of which are EYMS, Wellglade, Rotala, Transdev and Veolia Transport UK Ltd (Veolia) (Transdev and Veolia merged in March 2011). We refer to these as Non-Municipal Operators.

2.45 Based on the DfT’s estimate of operating revenues generated from local bus services and data provided to us by local bus operators, it is estimated (see Table 2.14) that the Large Operators account for 71 per cent of the reference area in terms of revenue. We note that this is similar to the share of supply that NBC and seven PTEs accounted for in 1985, and that currently no single operator has as high a share of supply as NBC had prior to its break-up (44 per cent, as shown in Table 2.10).

2.46 In England, the Large Operators account for 73 per cent of operating revenue. In Wales, the Large Operators account for 52 per cent of operating revenue. In Scotland, three operators, FirstGroup, Stagecoach and Lothian Buses, a Municipal Operator, have the largest shares and collectively account for 78 per cent of revenue generated by local bus services.

<table>
<thead>
<tr>
<th>TABLE 2.14 Local bus services—estimated shares of operating revenue, 2008/09</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market size (£m)</strong></td>
</tr>
<tr>
<td>--------------------</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>FirstGroup</td>
</tr>
<tr>
<td>Stagecoach</td>
</tr>
<tr>
<td>Arriva</td>
</tr>
<tr>
<td>Go-Ahead</td>
</tr>
<tr>
<td>National Express</td>
</tr>
<tr>
<td><strong>Large Operators</strong></td>
</tr>
<tr>
<td>Lothian Buses</td>
</tr>
<tr>
<td>NCT</td>
</tr>
<tr>
<td>Cardiff Bus</td>
</tr>
<tr>
<td>Reading Transport</td>
</tr>
<tr>
<td>Blackpool Transport</td>
</tr>
<tr>
<td><strong>Largest Municipal Operators</strong></td>
</tr>
<tr>
<td>Transdev</td>
</tr>
<tr>
<td>Wellglade</td>
</tr>
<tr>
<td>Rotala</td>
</tr>
<tr>
<td>EYMS</td>
</tr>
<tr>
<td>Veolia</td>
</tr>
<tr>
<td><strong>Mid-Sized Non-Municipal Operators</strong></td>
</tr>
<tr>
<td><strong>Other operators</strong></td>
</tr>
</tbody>
</table>

Source: DfT Annual Bus Statistics, Great Britain, 2009/10 (Table BUS0401a), operators’ response to financial data request, CC analysis.

26 Only Rotala’s revenue data was sourced from annual reports. All other data was based on operators’ respective Financial Questionnaire data submissions. We matched the responses of local operators to our financial data request with the DfT’s definition of operating revenues, which includes BSOG receipts and revenues related only to the provision of local bus services (excluding revenues for private hire, advertising, etc). We did not recalendarize any of the operator’s revenue figures but instead selected the operator’s financial year which fell closest to the DfT’s 12-month period to 31 March 2009.
2.47 The largest local bus operators in the reference area are discussed in more detail in Section 3.

Geographic distribution of operators

2.48 Figure 2.9 illustrates the geographic distribution of the Large Operators and other types of operator across local authorities in the reference area. Block colours illustrate areas where the indicated operator is the principal supplier of local bus services in that area (there are 211 such local authorities in the reference area, making up 61 per cent of all local authorities). Hatched shading indicates areas where two operators operate a substantial proportion of local bus services in an area (98 areas, 28 per cent of all local authorities). Pink shading indicates areas where three operators operate a substantial proportion of local bus services in an area (6 areas, 2 per cent of all local authorities). Other areas, of which there are 32, are shaded grey.
FIGURE 2.9

Geographic coverage of the largest operators’ networks

Source: CC analysis of Traveline data from October 2009, Ordnance Survey Boundary-line background mapping.

Note: For each local authority within the reference area, the map shows in block colours those areas where one of the Large Operators, a Mid-Sized Operator, a Small Operator or a Municipal Operator has a share of supply which is at least 35 per cent higher than the share of supply of the next largest operator in that authority. In areas where this condition does not hold, and the second largest operator in a local authority
has a share of supply of at least 20 per cent in the area, the identity of the second operator is shown with hatched shading. Areas where three operators have a share of supply of 20 per cent or more are shown in pink. Areas where no operator has a share of supply that is 35 per cent more than another operator, and no two or three operators have a share of supply of 20 per cent or more, are marked in grey.

2.49 The map shows that one of the Large Operators operates a substantial share of supply in almost all parts of the reference areas, in some cases alongside another operator. In general the Large Operators’ networks are concentrated in specific regions of the reference area—we consider the geographic distribution of these companies’ operations individually in section 3 of this report. Municipal operators are found only in a small number of local authorities in the reference area.

Policy and regulation

2.50 This section provides a summary of policy and regulation. A more detailed description is given in Section 12 and in Appendices 12.1 to 12.3. The national governments set policies relevant to local bus services in England, Scotland and Wales, and provide direct funding support to the industry and set the framework for additional funding at a local level.

2.51 In England, this role is administered for the Secretary of State for Transport through the DfT. As a result of devolution, the Scottish Government has been given specific responsibilities for transport policy and implementation and the Welsh Government has been given similar responsibilities for some of those areas.

2.52 The Scottish Government sets Scotland’s national bus policy and has introduced specific transport legislation. Certain ‘reserved matters’ are still the responsibility of the UK Parliament—for example, road safety and regulation.

2.53 In Wales, the legislative and regulatory framework around bus service registration, operator licensing and the Traffic Commissioner is not devolved, but other aspects of bus policy are. As a result, schemes such as concessionary travel operate in a different way across Wales compared with England.

2.54 There has also been a general reduction in the direct involvement of the central government in policy relating to local bus services, and a range of increasingly flexible powers given to LTAs or to regional groupings of LTAs. For example, LTAs have been given powers to enter into both voluntary and statutory schemes at a local level—see paragraph 2.75.

Funding

2.55 Significant public funds go into the bus industry—some of this stems from national policy initiatives with other aspects driven by decisions made at a local level. The main categories of spending are:

(a) Concessionary fares: concessionary travel schemes exist for older people and the registered disabled, although precise arrangements and eligibility for free bus travel varies between the different nations (and between areas in England). Operators are reimbursed for carrying such passengers; the reimbursement arrangements are intended to ensure that operators are no better or worse off than if there was no concessionary scheme. Further details of the operation of the scheme are given in Appendix 12.3.

(b) The BSOG is paid to all eligible operators of registered local bus services and offsets a proportion of the duty paid on fuel consumed—for example, in England
this is currently about 80 per cent of duty. Details of how the payments are made in England, Scotland and Wales are given in paragraphs 12.18 to 12.20.

(c) Supported services: funding to support services that would not otherwise be provided on a purely commercial basis, which local authorities consider appropriate, is made at a local level out of non-ring-fenced funds.

(d) Governments often run specific local bus service funding initiatives, for example to help the development of rural bus services or to provide an incentive for the development of new services. Examples have included Kickstart funding in England and the Bus Route Development Grant in Scotland.

(e) Significant capital spending is made on transport-related initiatives. Some are bus specific, such as bus priority lanes or measures, but other road improvement schemes can also have an impact on local buses.

2.56 Table 2.15 sets out estimated net support paid by central and local government for local bus services and concessionary travel in England. Overall support has increased substantially over the period, the largest element of which is concessionary travel, where expenditure increased markedly after 2005/06 with the extension of the concessionary scheme to national coverage. Although this is described as support, in principle operators do not benefit from the concessionary scheme as they are meant to be reimbursed to replicate the situation that would apply in the absence of the scheme, i.e. it is the concessionary passengers who are subsidized. In the case of net public transport support, supported service payments relate to the acquisition by LTAs of bus services that would not be provided commercially.

<table>
<thead>
<tr>
<th>Area/financial year</th>
<th>Net public transport support†</th>
<th>Concessionary travel‡</th>
<th>BSOG§</th>
<th>Total estimated net support¶</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996/97</td>
<td>189</td>
<td>276</td>
<td>161</td>
<td>626</td>
</tr>
<tr>
<td>1997/98</td>
<td>184</td>
<td>280</td>
<td>157</td>
<td>621</td>
</tr>
<tr>
<td>1998/99</td>
<td>219</td>
<td>296</td>
<td>185</td>
<td>701</td>
</tr>
<tr>
<td>1999/00</td>
<td>228</td>
<td>301</td>
<td>231</td>
<td>760</td>
</tr>
<tr>
<td>2000/01</td>
<td>237</td>
<td>310</td>
<td>254</td>
<td>801</td>
</tr>
<tr>
<td>2001/02</td>
<td>257</td>
<td>325</td>
<td>248</td>
<td>830</td>
</tr>
<tr>
<td>2002/03</td>
<td>276</td>
<td>322</td>
<td>251</td>
<td>850</td>
</tr>
<tr>
<td>2003/04</td>
<td>299</td>
<td>322</td>
<td>252</td>
<td>872</td>
</tr>
<tr>
<td>2004/05</td>
<td>304</td>
<td>347</td>
<td>257</td>
<td>908</td>
</tr>
<tr>
<td>2005/06</td>
<td>344</td>
<td>329</td>
<td>268</td>
<td>941</td>
</tr>
<tr>
<td>2006/07</td>
<td>351</td>
<td>562</td>
<td>270</td>
<td>1,184</td>
</tr>
<tr>
<td>2007/08</td>
<td>365</td>
<td>631</td>
<td>289</td>
<td>1,287</td>
</tr>
<tr>
<td>2008/09</td>
<td>383</td>
<td>744</td>
<td>310</td>
<td>1,437</td>
</tr>
<tr>
<td>2009/10</td>
<td>381</td>
<td>788</td>
<td>308</td>
<td>1,479</td>
</tr>
<tr>
<td>2010/11</td>
<td>386</td>
<td>814</td>
<td>312</td>
<td>1,512</td>
</tr>
</tbody>
</table>

Source: CC analysis based on DfT Bus Statistics Table BUS0502a (www.dft.gov.uk/pgr/statistics/datatablespublications/public/bus/). The 2010/11 figures are provisional.

*These figures are not adjusted for inflation.
†Public Transport Support is the total of all local authorities’ net costs incurred in support of bus services, either directly or by subsidies to operators or individuals. The bulk of these costs will be accounted for by payments to operators providing supported bus services (including non-local services in some cases). However, the figures also include administration costs and inter-authority transfers, meaning that a small proportion of the sums shown will not reach bus operators.
‡Concessionary Fare Reimbursement is the total of all local authorities’ net costs of statutory or discretionary concessionary bus travel. Discretionary concessionary travel support is provided by local authorities, and can include travel for those not included within the statutory concession, travel within the peak, or travel on modes other than bus. These figures have been adjusted to exclude significant non-public transport concessions where known (e.g. light rail, or national rail journeys within some metropolitan areas). However, local authority taxi token funding cannot be separately identified, and is therefore counted in these figures. The figures include administration costs, meaning that a small proportion of the sums shown will not reach bus operators.
§BSOG is a subsidy provided by national governments to operators of local bus services. The distribution of BSOG payments between London, English Metropolitan areas and English Non-Metropolitan areas is an estimate.

Figures reflect net revenue cost to the public purse. Gross expenditure is offset by income sources, including local authority income from passenger fare receipts on some supported services. Capital funding support for local bus services is excluded.

2.57 The Comprehensive Spending review and other strategic reviews of spending are expected to have a significant effect on the amount of public funds available for local bus services. In England, BSOG will be cut by 20 per cent from April 2012 (see paragraph 12.18) and generally there is pressure on local authority funding. It is expected that many LTAs will substantially reduce expenditure on supported services—see paragraphs 13.12 and 13.13. Schemes such as concessionary fares have been subject to review in all nations and further changes to the method and level of reimbursement are possible.

**Licensing and registration**

2.58 The licensing of bus operators and the registration of bus services outside London is the responsibility of the Traffic Commissioners—see paragraphs 12.31 to 12.49.

2.59 The seven Traffic Commissioners are appointed by the Secretary of State for Transport27 and have responsibility in their Traffic area28 for:

(a) the licensing of the operators of heavy goods vehicles (HGVs) and of buses and coaches (Public Service Vehicles or PSVs29) and consideration of regulatory action against non-compliant officers;

(b) the registration of local bus services outside London;

(c) issuing permits under sections 19 and 22 (voluntary and community buses) of the 1985 Act (as amended);

(d) regulating the conduct of vocational licence holders; and

(e) monitoring and regulation of operator’s compliance with local bus service registrations.

2.60 The Commissioners’ primary aim is to champion safe, fair and reliable passenger and goods transport. Commissioners are statutorily independent in all their licensing functions. When necessary, they hold regulatory public inquiries, and they consider the possibility of disciplinary action against PSV drivers at driver conduct hearings.

2.61 One Traffic Commissioner is the Senior Traffic Commissioner, a statutory appointment which requires him to provide statutory guidance to colleagues30 to help secure consistency in licensing decisions and procedures without comprising judicial independence.

2.62 Each bus operator needs to apply for a PSV operator’s licence from a Traffic Commissioner in the relevant area and must meet a number of statutory criteria for

27 The Traffic Commissioner for Scotland is appointed in consultation with Scottish Ministers.

28 There are in fact eight traffic areas: North Western, Scottish, South Eastern and Metropolitan, Eastern, Western and North Eastern, Welsh and West Midlands (the latter two areas are covered by the same Traffic Commissioner). The role is set out at www.dft.gov.uk/pgr/roads/tpm/trafficcommissioners/.

29 PSVs are defined in section 1 of the Public Passenger Vehicles Act 1981 as a vehicle adapted to carry more than eight passengers and carrying passengers for hire or reward or a vehicle not so adapted carrying passengers for hire at separate fares and not classified as a taxi or where the arrangements are not made by the vehicle owner/ licence holder. Local buses would be operated with PSVs.

30 The registration and regulation of local bus services is a devolved matter to the Scottish Parliament and the Traffic Commissioner for Scotland reports to Scottish Ministers on these matters.
eligibility, these being that the applicant must: be of good repute; have appropriate financial standing; and be professionally competent.

2.63 All local bus services outside London must be registered with the Traffic Commissioner for the relevant area.

2.64 In England and Wales, a bus operator can provide a new local bus service after providing details of the service including the route and timetable and giving 56 days’ notice to the Traffic Commissioner, although there is the discretion to accept shorter notice periods. Similar notice must be given for changes or withdrawals of services. In Scotland, an additional 14 days’ prior notice must be given to the local authority. Frequent services (ie those with a frequency of 10 minutes or less) do not have to register a timetable.

2.65 Traffic Commissioners have the power to take action if an operator no longer meets the conditions of its licence or does not operate services in line with the registration that it made. Bus Compliance Officers employed by the Vehicle and Operator Services Agency (VOSA) monitor services and report on compliance with registered particulars of the routes, and with any Traffic Regulation Conditions in place to the Traffic Commissioners. The Traffic Commissioner sets punctuality standards against which the reliability of local bus services is measured. The standards and penalties currently applicable are set out in The Senior Traffic Commissioner’s 2005 Practice Direction.31

2.66 A Traffic Commissioner, when discharging regulatory functions, acts in a judicial capacity as a single person tribunal. Where an operator’s breach is not serious, the matter may be dealt with by correspondence, through the issue of a warning letter. In many cases of non-compliance, the Traffic Commissioner will require the operator to attend a public inquiry.

2.67 In the UK, competition law is applied and enforced principally by the OFT. The Competition Act 1998 (the 1998 Act) gives it powers to apply, investigate and enforce Chapter I and Chapter II prohibitions under the 1998 Act and Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU).32 There are two key exceptions to the application of the 1998 Act which affect local bus services.

(a) There are two separate competition tests which apply to different types of agreements in local bus markets. These can include, for example, agreements between operators on timetable frequency which are overseen by the LTA. Ordinarily such arrangements between operators may infringe competition law but are instead subject to a competition test which allows an exemption based on certain criteria. The practical result is that the OFT does not have the power to impose fines on operators under these tests. Details of the competition tests are given in Appendix 12.1, Annex B. The OFT has the power to investigate whether the agreement or scheme in question satisfies the relevant competition test. It would normally do so after receipt of a complaint or on its own initiative, and subject to its administrative priorities.

(b) There is a block exemption to the 1998 Act for certain types of public transport ticketing schemes agreed on a voluntary basis between operators. Although these may have a harmful impact on competition for the purposes of section 2 of

31 This can be found at www.dft.gov.uk/vosa/repository/PD%20standards%20for%20local%20buses.pdf.
32 The TFEU and the 1998 Act both prohibit, in certain circumstances, agreements and conduct which prevent, restrict or distort competition, and conduct which constitutes an abuse of a dominant position.
the 1998 Act, they can also result in benefits which outweigh their negative impact on competition.  

2.68 Under the 2002 Act, the OFT reviews relevant local bus mergers and refers to the CC any where it believes to be a realistic prospect of a substantial lessening of competition (SLC). The CC then determines whether on the balance of probabilities there is or may be an SLC and if so what remedial action should be taken.

**Local policy implementation**

2.69 There are 132 LTAs operating in the reference area. An LTA is:

(a) a county council in England; or

(b) a council of a non-metropolitan district in England in an area for which there is no County Council (unitary authorities); or

(c) an Integrated Transport Authority for a passenger transport area in England (these areas are defined as the six metropolitan counties); a PTE for each plans and runs transport and reports to the authority; or

(d) a county council or county borough council in Wales; or

(e) a local authority or Strathclyde Partnership for Transport (formerly Strathclyde Passenger Transport Authority) in Scotland.

2.70 LTAs are responsible for setting and implementing overall strategies and policies for transport within their areas. LTAs can enter into certain formal or informal arrangements with bus operators relating to the nature and standard of delivery of commercial services (see Table 2.16). In addition, they can tender contracts with bus operators for the operation of local bus services which would otherwise not be run at all or to the required standard on a commercial basis.

2.71 Shire district councils have a relevant role as they negotiate and fund concessionary travel schemes and set local policy for parking, land use and planning and invest in bus infrastructure. Metropolitan district councils can invest in bus priority measures and also set local policy on parking, land use and planning.

2.72 In addition, The Transport (Scotland) Act 2005 created seven regional Transport Partnerships in Scotland to strengthen the planning and delivery of regional transport. The Scottish Ministers have the ability to extend the role of the Transport Partnerships to either adopt or manage concurrently certain functions of the LTA. The powers have been extended in some (but not all) regions. In Scotland, LTAs are required to perform their functions in a manner consistent with the strategy of the Transport Partnership for the area.

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33 Further details are given in Appendix 12.1, Annex B.
34 Section 108(4) of the 2000 Act and section 82(1) of the Transport (Scotland) Act 2001.
35 Integrated Transport Authorities were formally known as Passenger Transport Authorities and are Centro (West Midlands); Greater Manchester Combined Authority; Merseytravel (Merseyside); Metro (West Yorkshire); Nexus (Tyne & Wear); and South Yorkshire.
36 Strathclyde Partnership for Transport is a regional Transport Partnership.
37 From 1 April 2011, formal responsibility for administration of the scheme passed to LTAs.
38 Shire district councils in England are able to contract for operators to provide socially necessary bus services (section 63(4) of the 1985 Act).
2.73 In Wales, the Welsh Government has established four Regional Transport Consortia made up of local authorities, which have responsibility for delivery at a regional level. The Welsh Government has required each to prepare a Regional Transport Plan for the period 2010 to 2015.

2.74 To help implement their plans, LTAs have at their disposal a variety of powers to regulate local bus markets subject to meeting the criteria specified in the legislation and in particular to passing the appropriate part of the ‘competition test’ which is set out in Appendix 12.1, Annex B.

**Voluntary and statutory schemes**

2.75 LTAs can enter into voluntary or statutory agreements with operators. In practice, the majority of such arrangements are voluntary with relatively few statutory partnerships and no quality contracts in place. Table 2.16 summarizes the range of arrangements that LTAs may be involved with and these are described in more detail in 12.85 to 12.106.

<table>
<thead>
<tr>
<th>TABLE 2.16</th>
<th>Local bus services LTA schemes and arrangements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Role of bus operator(s)</strong></td>
<td><strong>Role of LTA</strong></td>
</tr>
<tr>
<td>Quality Partnership Schemes (Competition Test Part 1)</td>
<td>Operators must provide services to a particular standard in this statutory scheme. This can include frequencies, timings or maximum fare</td>
</tr>
<tr>
<td>Voluntary partnership agreements (Competition Test Part 2)</td>
<td>Operator(s) undertake to provide services to a particular standard (e.g., new vehicles)</td>
</tr>
<tr>
<td>Qualifying agreements (Competition Test Part 2)</td>
<td>Agreements between bus operators only—for example, to coordinate timetables on an overlapping route</td>
</tr>
<tr>
<td>Quality Partnership Schemes (Competition Test Part 1)</td>
<td>Similar to voluntary scheme as operator(s) undertake to provide services to a particular standard but this is a statutory scheme. This can include frequencies, timings or maximum fares</td>
</tr>
<tr>
<td>Quality Contracts Schemes (a public interest test applies)</td>
<td>Tender to operate contracts to LTA specification</td>
</tr>
<tr>
<td>Ticketing Schemes (Competition Test Part 1)</td>
<td>Operators must make arrangement to issue multi-operator/through tickets or add-ons to other transport, e.g., trams</td>
</tr>
</tbody>
</table>

Source: CC analysis.

39 These are Taith (North Wales), TRACC (mid-Wales), SWWITCH (south-west Wales) and SEWTA (south-east Wales).

40 Voluntary partnership arrangements have not been formalized in legislation in Scotland although there are numerous voluntary agreements between operators and local authorities. There are also important differences in the standards that can be set in statutory schemes and in the nature of Quality Contract schemes in Scotland which are detailed in Appendix 12.1, paragraph 68.
Supported services

2.76 LTAs have a duty (apart from non-metropolitan district councils which have a power) to secure the provision of public transport services that they consider appropriate to meet social needs and that would not otherwise be available to a desired standard—for example, in rural areas. They have a duty to take account of the needs of elderly and disabled people in making this assessment.

2.77 LTAs must generally invite competitive tenders for any contract providing for service subsidies. In deciding which tender to accept, LTAs must have regard to a combination of economy, efficiency and effectiveness; the implementation of the policies set out in the bus strategy; and the reduction or limitation of traffic congestion, noise or air pollution. Furthermore, where tenders are in excess of EU financial limits the local authority must comply with the EU procurement rules.

Concessionary travel schemes

2.78 The policy principle of providing some degree of concessionary travel to older bus passengers in particular is well established, although the precise coverage of the concession (for example, hours of operation) varies between the nations in the reference area. The cost of the concession is reimbursed to bus operators through public funds.

2.79 In England, the basis for the reimbursement of operators for concessionary travellers is determined locally although guidance is provided by the DfT. The DfT issued new guidance in November 2010 which is applicable to schemes applied from April 2011.

2.80 In Wales, national parameters for reimbursement are set out although there is discretion for local authorities to negotiate local variations. In Scotland, a national scheme with a common basis for reimbursement is operated.

Passenger and trade bodies

2.81 There are a number of other bodies which have either an official or unofficial role in the local bus market. These include Passenger Focus, which from April 2010 became the independent bus and coach passenger champion to the industry in England. Its aim is to improve services for passengers, and it seeks to do this through an emphasis on evidence-based campaigning and research. There are similar bodies in Scotland and Wales now established. There are a number of independent groups such as Bus Users UK, which operates in England and Wales, that deal with complaints that passengers are unable to resolve directly with operators.

2.82 There are also groupings such as the Confederation of Passenger Transport, a trade association for bus, coach and light rail industry operators and for LTAs through the Association of Transport Co-ordinating Officers (ATCO).

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41 There are exceptions where action is urgently required for the purpose of maintaining an existing service or based on local authorities spending a certain amount of contracts can be agreed under the de minimis exemption on a bilateral basis between an operator and the LTA.
42 Section 89, 1985 Act.
43 See www.bususers.org/.
3. Bus operating companies

Introduction

Local bus operators

3.1. This section sets out brief profiles of a selection of local bus operators within the reference area (further details can be found in Appendix 3.1). The 15 operators profiled in this section account for a combined 82 per cent share\(^1\) of local bus service revenues within the reference area, of which the Large Operators account for a combined market share of around 70 per cent. We have referred to the remaining ten operators profiled in this section as Mid-Sized Operators and divided them between Mid-Sized Non-Municipal Operators and Mid-Sized Municipal Operators depending on the operator’s ownership structure (see paragraph 2.44\((b)\) for a list of all Municipal Operators). The five Mid-Sized Non-Municipal Operators account for around 5 per cent of the market; and the five Mid-Sized Municipal Operators for which we received detailed financials, around 6 per cent of the market.

Classification of local bus operators

3.2. We classify a local bus operator as a Large or Mid-Sized Operator primarily based on our assessment of their:

\(a)\) total number of registered local bus services\(^2\) in the reference area; and

\(b)\) total local bus PSV fleet size.

3.3. We rank each operator within each operator category based on their total number of registered local bus services within the reference area, weighted by total frequency (in descending order).\(^3\) The number of registered local bus services for the largest three operators (i.e., Stagecoach, FirstGroup and Arriva) is distinctly larger relative to the other operators within the reference area (see also Appendix 3.1, Table 1).

Operators ranked by the number of registered services

Large Operators
Stagecoach
FirstGroup
Arriva (a Deutsche Bahn AG subsidiary)
National Express
Go-Ahead

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\(^1\) Market share analysis based on each operator’s operating revenues (based on the DfT’s definition, which includes BSOG, concessionary fare reimbursement, contracts, other public transport support to operators and passenger fare receipts) as a percentage of total operating revenues in the reference area. Reference area market size based on 2008/09 data from the DfT’s Table BUS0401a. Each operator’s financials have been taken from its financial year closest to the DfT’s 2008/09 reporting year.

\(^2\) Based on Traveline data for October 2009.

\(^3\) Source: CC analysis of Traveline data for October 2009, with the exception that the number of registered services for Plymouth Citybus have been allocated to Go-Ahead Group, and those for Islwyn Borough Transport have been allocated to Stagecoach, despite these acquisitions taking place after October 2009. Frequency weighting has been applied by weighting the number of routes operated by each company by the total weekly frequency of those routes (i.e., the number of scheduled departures on the routes in the course of a week).
Operators which are wholly or majority owned by local authorities are classified as Municipal Operators. The strategic objectives of Municipal Operators are often aligned with the public transport policy of their respective local authority owners, including the prioritization by the Municipal Operator of certain aspects of social inclusion and the ‘social dividend’ (eg see descriptions of the business strategy for Lothian Buses (see paragraph 3.69) and Blackpool Transport (see paragraph 3.81). For this reason, we considered it appropriate to distinguish between Municipal Operators and others during our investigation.

The Large Operators

Stagecoach

Business overview

3.5. Headquartered in Perth, Stagecoach is an operator of bus, coach and rail services in the UK and North America. Aside from its UK local bus operations, Stagecoach also operates the South Western Trains and East Midlands Trains rail franchises in Great Britain, as well as the Sheffield Supertram light rail service. It also delivers budget inter-urban express services under the megabus.com brand. Through a number of joint ventures, Stagecoach is also involved in the operation of the West Coast Trains rail franchise (through its 49 per cent equity stake in Virgin Rail Group) and Scottish Citylink coach services. Scottish Citylink delivers all megabus.com branded services operating to, from and within Scotland. In North America, Stagecoach provides bus and coach transport services through its megabus.com, Coach USA and Coach Canada brands, as well as operating sightseeing buses in New York through its Twin America LLC joint venture. Stagecoach is listed on the London Stock Exchange and currently has a market capitalization of around £1.4 billion. For its financial year ended 30 April 2011, the group generated total consolidated revenues of £2.4 billion.

3.6. Stagecoach’s UK bus business, which comprises both local bus and non-local bus (eg private contract bus and coach) operations, manages a fleet of around 7,000 buses and coaches, and during its financial year ended 30 April 2011 generated total revenues of £1.0 billion. Stagecoach re-entered the regulated London local bus market with its acquisition of the East London Bus Group in October 2010, making Stagecoach one of the largest bus operators in London. Within the reference area, Stagecoach’s local bus operations generated total revenues of £[X] million, with...

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4 Based on the combined number of registered services for Transdev and Veolia. The merger of Veolia Transport SA and Transdev completed on 3 March 2011.
Stagecoach having the highest number of registered services after weighting by total frequency.

3.7. Stagecoach manages its local bus operations in the reference area with around 6,700 buses through 18 regional operating companies, although Stagecoach told us [\textsuperscript{[2]}]. Stagecoach told us that it maintained a relatively flat and devolved management structure and that most operational and commercial decisions were made at the level of the regional operating company.

3.8. Figure 3.1 shows Stagecoach’s local bus operations in the reference area.

FIGURE 3.1

Map showing Stagecoach’s local bus operations in the reference area as at October 2009

Source: CC analysis of Traveline data for October 2009. Map includes Islwyn Borough Transport for Stagecoach, whose acquisition was announced by Stagecoach in January 2010.

Notes:
1. Maps are based on Traveline data for October 2009. The data is subject to some limitations which may impact upon the accuracy of these maps—see Appendix 4.1 for more details.
2. An operator’s area of operation is illustrated by colouring those local authorities in which the operator runs local bus routes. Under this methodology the geographic distribution of an operator’s routes within a local authority will be hidden. An operator will be shown as serving a local authority even if they run services only on the edge of the area, or operate only a single route in the area.
3. Shares of supply for each local authority are calculated as the total number of weekly services run on an operator’s bus routes which cover a distance of at least 500 metres in the authority, divided by the total number of weekly services run on all bus routes which cover a distance of at least 500 metres in the authority.

4. The 10 per cent share of supply threshold is employed in order to distinguish between local authorities which are more and less likely to be key areas for the operator. In some instances the threshold may be misleading, in that a larger market share may reflect a relatively small scale of operations in an authority with relatively few local bus routes, but will reflect much more significant operations in an authority with a large number of local bus routes.

**Brief history of Stagecoach’s local bus operations**

3.9. From its origins as a self-drive caravan rental business which was established in 1976 in Perth, Stagecoach entered the newly deregulated coach market in 1980, operating coach services within Scotland and longer-distance journeys between Scotland and London. Stagecoach began its rapid expansion into local bus services with the privatization of the NBC, when it acquired Hampshire Bus, Cumberland Motor Services and United Counties in 1987.

3.10. Since 1987, Stagecoach continued its expansion with further acquisitions, of which some of the major acquisitions are listed in Appendix 3.1, Table 6, including the Liverpool-based bus operator, Glenvale Transport, and the Traction Group, together with its subsidiaries in South and West Yorkshire, Lincolnshire and Tayside. In January 2010, Stagecoach acquired the entire share capital of Islwyn Borough Transport Ltd. In October of that same year, having exited the regulated London local bus market in 2006, Stagecoach re-entered the market, when it acquired three subsidiaries from East London Bus Group.

**Business strategy**

3.11. Stagecoach told us that whilst, historically, the group had grown quickly through acquisitions, these were no longer the key growth drivers. Stagecoach told us that it was currently focusing on generating organic growth and [x].

**FirstGroup**

**Business overview**

3.12. Headquartered in Aberdeen, FirstGroup is a provider of public transport services in the UK, the Republic of Ireland, Germany and North America. Aside from its local bus operations in the UK, FirstGroup also operates the Great Western, Capital Connect, TransPennine Express, ScotRail rail franchises and the open access rail operator Hull Trains. FirstGroup is listed on the London Stock Exchange with a market capitalization of around £1.6 billion, and for its financial year ended 31 March 2011, generated total consolidated revenues of £6.4 billion.

3.13. For its financial year ended 31 March 2011, FirstGroup’s UK bus operations (including the areas outside the reference area and non-local bus activities such as coaching) accounted for £1.1 billion of group revenues and it managed a fleet of around 8,000 buses, of which its local bus operations within the reference area accounted for £[x] million and around 6,500 buses respectively. Within the reference area, FirstGroup has the second highest number of registered services after weighting by total frequency.

3.14. FirstGroup manages its UK local bus operations within the reference area through 13 operating companies which are managed by five Regional Managing Directors, with one Regional Managing Director for each of the following areas: London (cover-
The First Berkshire OpCo which also serves the reference area), Scotland, the North of England, the South-East of England and the South-West of England. Regional Managing Directors have primary responsibility over their respective areas and operating companies, in particular ensuring consistency of service for all of its local operations. FirstGroup told us that strategic and tactical decisions, however, were primarily made at the operating company level.

3.15. Figure 3.2 shows FirstGroup’s local bus operations in the reference area.

**FIGURE 3.2**

Map showing FirstGroup’s local bus operations in the reference area as at October 2009

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Source: CC analysis of Traveline October 2009 data.

Notes:
1. Maps are based on Traveline data for October 2009. The data is subject to some limitations which may impact upon the accuracy of these maps—see Appendix 4.1 for more details.
2. An operator's area of operation is illustrated by colouring those local authorities in which the operator runs local bus routes. Under this methodology the geographic distribution of an operator's routes within a local authority will be hidden. An operator will be shown as serving a local authority even if they run services only on the edge of the area, or operate only a single route in the area.
3. Shares of supply for each local authority are calculated as the total number of weekly services run on an operator's bus routes which cover a distance of at least 500 metres in the authority, divided by the total number of weekly services run on all bus routes which cover a distance of at least 500 metres in the authority.
4. The 10 per cent share of supply threshold is employed in order to distinguish between local authorities which are more and less likely to be key areas for the operator. In some instances the threshold may be misleading, in that a larger market share may reflect a relatively small scale of operations in an authority with relatively few local bus routes, but will reflect much more significant operations in an authority with a large number of local bus routes.

**Brief history of FirstGroup’s local bus operations**

3.16. FirstBus plc, which was renamed FirstGroup in 1998, was first formed in 1995 following the merger of two UK-listed bus groups: Badgerline Group (which originated from the management buyout of the Avon-based company from the NBC in 1986) and GRT Bus Group (a former Municipal Operator based in Aberdeen which in 1989 was itself subject to a management buyout).

3.17. The group expanded its UK local bus operations through a series of very sizeable acquisitions between 1995 and 1999 (see Appendix 3.1, Table 9). Expansion continued with a number of smaller acquisitions from 1999 onwards. FirstGroup’s first disposal was in 2007 when it sold Orpington Buses to Go-Ahead’s Metrobus.

**Business strategy**

3.18. FirstGroup told us that it had not identified much scope for new acquisition opportunities. FirstGroup also told us that its medium-term strategy was to focus on growing its business organically, whilst identifying any commercial opportunities to enter new markets.

**Arriva**

**Business overview**

3.19. Headquartered in Sunderland, Arriva is an operator of bus and rail services in the UK and in 11 European countries. In Great Britain, Arriva also operates an extensive rail network through its CrossCountry and Welsh rail franchises. For its financial year ended 31 December 2009, across its entire operations, Arriva generated total consolidated revenues of £3.1 billion, of which around half was generated outside the UK. Following its acquisition on 27 August 2010, Arriva was delisted from the London Stock Exchange and is now a wholly-owned subsidiary of Deutsche Bahn AG, a multinational transport and logistics provider based in Germany. The acquisition valued Arriva’s issued and to-be-issued share capital at approximately £1.6 billion. Following its acquisition by Deutsche Bahn, Arriva’s mainland European operations and subsidiaries continue to remain under Arriva’s management. All of Deutsche Bahn’s regional passenger transport operations outside Germany have now come under Arriva’s control (see Appendix 3.1 for further details).

3.20. Arriva’s bus operations in Great Britain (including London) comprise a total fleet of around 5,900 buses and generated total revenues of £961.5 million for its financial year ended 31 December 2009. Its local bus operations in the reference area accounted for around 4,100 buses and £[X] million of revenues for its financial year ended 31 December 2009, around 18 per cent of Arriva’s group revenues (for its financial year ended 31 December 2010, Arriva’s local bus operations in the reference area generated total revenues of £[X] million—see Appendix 3.1, Table 11).

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5 Following its acquisition by Deutsche Bahn AG, Arriva is still a public limited company and has not re-registered as a private limited company.
Within the reference area, Arriva has the third highest number of registered services after weighting by total frequency.

3.21. Arriva manages its local bus operations (excluding London) through eight regional operating companies, covering the North-East, North-West and South-East of England, Yorkshire, the Midlands, Scotland and Wales. Figure 3.3 shows Arriva's geographic coverage.

FIGURE 3.3

Map showing Arriva’s local bus operations in the reference area as at October 2009

Source: CC analysis of Traveline data for October 2009.
Notes:
1. Maps are based on Traveline data for October 2009. The data is subject to some limitations which may impact upon the accuracy of these maps—see Appendix 4.1 for more details.
2. An operator’s area of operation is illustrated by colouring those local authorities in which the operator runs local bus routes. Under this methodology the geographic distribution of an operator’s routes within a local authority will be hidden. An operator will be shown as serving a local authority even if they run services only on the edge of the area, or operate only a single route in the area.
3. Shares of supply for each local authority are calculated as the total number of weekly services run on an operator’s bus routes which cover a distance of at least 500 metres in the authority, divided by the total number of weekly services run on all bus routes which cover a distance of at least 500 metres in the authority.
4. The 10 per cent share of supply threshold is employed in order to distinguish between local authorities which are more and less likely to be key areas for the operator. In some instances the threshold may be misleading, in
that a larger market share may reflect a relatively small scale of operations in an authority with relatively few local bus routes, but will reflect much more significant operations in an authority with a large number of local bus routes.

**Brief history of Arriva’s local bus operations**

3.22. Established in 1938 as a second-hand motorcycle shop in Sunderland under the name Cowie, Arriva first moved into local bus services in London in 1986 supplying bus services under contract to London Buses (then part of London Transport), through its subsidiary Grey-Green Coach and Bus Company (itself acquired as part of Arriva’s acquisition of motor retailer George Ewer and Co Ltd in 1980). This was followed by its acquisition of Country Bus in 1996, a local bus operator in Hertfordshire and Essex. In 1996, Arriva acquired the British Bus Group (formerly the Drawlane Group), a company which had grown rapidly through a series of acquisitions of former NBC subsidiaries. In 1997, the company changed its name from Cowie to Arriva. Some of Arriva’s major acquisitions are listed in Appendix 3.1, Table 12.

3.23. Arriva’s acquisition of MTL Services in Merseyside in 2000 resulted in the group becoming one of the largest local bus operators outside London, albeit the acquisition was subject to an investigation by the CC which resulted in Arriva selling one of its depots (Gilmoss in Liverpool). There was some retrenchment in Arriva’s local bus operations between 2001 and 2004 (including the closures of Arriva North Surrey and Arriva West Sussex), before expansion resumed in 2005 when Arriva made a series of acquisitions, including MK Metro in Milton Keynes and ATS Chase in the Midlands. Arriva also took a 40 per cent stake in Centrebus Holdings Limited (Centrebus Holdings), which operates local bus services in Huddersfield, Bradford and Leeds in Yorkshire, out of its two depots under the trading names Centrebus, Huddersfield Bus Company and K-Line. The results for Centrebus Holdings are not consolidated within Arriva’s UK Bus financials in Appendix 3.1, Table 11. Arriva does not have a stake in Centrebus Limited, which predominantly operates in areas where Arriva has scaled back its own operations, although it does compete against Arriva on some routes in Leicester, Luton and Stevenage.

**Business strategy**

3.24. Arriva told us that a knowledge and understanding of the local marketplace was needed to effectively meet its local stakeholders’ needs and therefore each regional operating company had its own management team and was given primary responsibility over its own operations.

3.25. Arriva’s medium-term strategy for its local bus operations was to manage its business in light of the market’s longer-term decline; find further efficiencies; and improve partnerships with LTAs.

**National Express**

**Business overview**

3.26. Headquartered in Birmingham, National Express is an operator of coach, rail and bus services in the UK (around 54 per cent of its group revenues) and bus services in Spain and North America. In Great Britain, National Express operates the c2c and National Express East Anglia (which includes Stansted Express) rail franchises. National Express also operates the Midland Metro and the West Midlands light rail service between Birmingham and Wolverhampton. Listed on the London Stock
Exchange with a current market capitalization of around £1.1 billion, National Express generated total consolidated revenues of £2.1 billion for its financial year ended 31 December 2010.

3.27. National Express no longer operates local bus services in London, having disposed of its London bus operations in 2009. It focuses its provision of local bus services in the West Midlands and Dundee, with a total fleet of around 1,600 buses. Within the reference area, National Express has the fourth highest number of registered services after weighting by total frequency. For its financial year ended 31 December 2010, National Express’s local bus operations generated total revenues of £[3<] million.

3.28. National Express provides its local bus services through two wholly-owned subsidiaries: West Midlands Travel Ltd (West Midlands) under the National Express Coventry and National Express West Midlands brands; and Tayside Public Transport Company Ltd under the Travel Dundee brand. During its financial year ended 31 December 2010, West Midlands Travel accounted for around 94 per cent of its local bus operations’ revenues.

3.29. Figure 3.4 shows National Express’s local bus operations in the reference area.
FIGURE 3.4
Map showing National Express’s local bus operations in the reference area as at October 2009

Source: CC analysis of Traveline data for October 2009.
Notes:
1. Maps are based on Traveline data for October 2009. The data is subject to some limitations which may impact upon the accuracy of these maps—see Appendix 4.1 for more details.
2. An operator’s area of operation is illustrated by colouring those local authorities in which the operator runs local bus routes. Under this methodology the geographic distribution of an operator’s routes within a local authority will be hidden. An operator will be shown as serving a local authority even if they run services only on the edge of the area, or operate only a single route in the area.
3. Shares of supply for each local authority are calculated as the total number of weekly services run on an operator’s bus routes which cover a distance of at least 500 metres in the authority, divided by the total number of weekly services run on all bus routes which cover a distance of at least 500 metres in the authority.
4. The 10 per cent share of supply threshold is employed in order to distinguish between local authorities which are more and less likely to be key areas for the operator. In some instances the threshold may be misleading, in that a larger market share may reflect a relatively small scale of operations in an authority with relatively few local bus routes, but will reflect much more significant operations in an authority with a large number of local bus routes.

**Brief history of National Express’s local bus operations**

3.30. National Express was formed from the management buyout of the NBC’s long-distance coach operations in 1988. Until 1994, National Express maintained its
primary business focus on coach operations, making just one acquisition of a local bus operator in 1989 (Crossville Wales), which it disposed of two years later.

3.31. In 1995, National Express acquired Birmingham-based West Midlands Travel, including its subsidiary North East Bus which was subsequently sold to Arriva in 1996, followed by the Black Country operator Merry Hill Minibuses and the Dundee-based Taybus Holdings (later renamed Travel Dundee) in 1997.

**Business strategy**

3.32. National Express told us that whilst it had considered a number of potential acquisition opportunities, its main focus was to generate organic growth. Its key strategy was therefore to stabilize the business and focus on cost management and increasing patronage through further marketing.

**Go-Ahead**

**Business overview**

3.33. Headquartered in London and listed on the London Stock Exchange with a current market capitalization of around £0.6 billion, Go-Ahead provides bus and rail services in the UK. It operates the Southern, Southeastern and London Midland rail franchises in Great Britain through its 65 per cent stake in a joint venture with Keolis SA. Go-Ahead’s only operation outside the UK is a joint-venture in North America, which has recently started operating in the contract yellow school bus market. For its financial year ended 2 July 2011, the group generated total consolidated revenues of £2.3 billion.

3.34. With a total combined fleet of around 3,900 buses, of which around half operate outside the regulated London local bus market, Go-Ahead’s UK local bus business generated total revenues of £642.4 million in its financial year ended 2 July 2011. Go-Ahead is the largest operator in the regulated London local bus market. Outside the London market, Go-Ahead’s local bus business generated total revenues of £[£] million. Within the reference area, Go-Ahead has the fifth highest number of registered services after weighting by total frequency.

3.35. Go-Ahead’s local bus operations are predominantly based in London and the South-East and, unlike some other multi-regional operators, focus on the local brands of its eight operating companies: Go North East, Brighton & Hove, Oxford Bus Company, Metrobus, Go South Coast, Plymouth CityBus, Konectbus and Thames Travel (acquired in 2011). Each operating company’s Managing Director is primarily responsible for its own local market and Go-Ahead deliberately maintains a highly decentralized operating structure to minimize the burden of administrative costs and other overheads on its operating companies.

3.36. Figure 3.5 shows Go-Ahead’s local bus operations in the reference area. We have excluded Konectbus’s operations from the map since Go-Ahead completed its acquisition of Konectbus in March 2010, and a substantial proportion of data we received from Go-Ahead did not include Konectbus as part of Go-Ahead.

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6 Whilst headquartered in London, Go-Ahead’s registered offices are based in Newcastle upon Tyne.

7 Excludes Go-Ahead’s London OpCo and approximately 70 per cent of Metrobus, which is predominantly focused on TfL contracts.
Map showing Go-Ahead's local bus operations in the reference area as at October 2009

Source: CC analysis of Traveline data for October 2009.
Notes:
1. Maps are based on Traveline data for October 2009, with the exception that Go-Ahead’s acquisition of Plymouth Citybus (acquired in December 2009) is shown, but the acquisition of Konectbus (acquired in March 2010) is not. The data is subject to some limitations which may impact upon the accuracy of these maps—see Appendix 4.1 for more details.
2. An operator’s area of operation is illustrated by colouring those local authorities in which the operator runs local bus routes. Under this methodology the geographic distribution of an operator’s routes within a local authority will be hidden. An operator will be shown as serving a local authority even if they run services only on the edge of the area, or operate only a single route in the area.
3. Shares of supply for each local authority are calculated as the total number of weekly services run on an operator’s bus routes which cover a distance of at least 500 metres in the authority, divided by the total number of weekly services run on all bus routes which cover a distance of at least 500 metres in the authority.

4. The 10 per cent share of supply threshold is employed in order to distinguish between local authorities which are more and less likely to be key areas for the operator. In some instances the threshold may be misleading, in that a larger market share may reflect a relatively small scale of operations in an authority with relatively few local bus routes, but will reflect much more significant operations in an authority with a large number of local bus routes.

_Brief history of Go-Ahead’s local bus operations_

3.37. Go-Ahead was formed from the management buyout of the Northern General Transport Company from the NBC in 1987, which was the single largest NBC subsidiary to be privatized. Rapid expansion of the group first started in 1993 with its listing on the London Stock Exchange and its acquisition of the municipal operator, Brighton & Hove.

3.38. Go-Ahead continued its expansion with the following major acquisitions: Oxford Bus Company (acquired in 1994), Metrobus (acquired in 1999), Go South Coast (businesses acquired between 2003 and 2006), Plymouth CityBus (acquired in December 2009), Konectbus in Norfolk (acquired in March 2010) and Thames Travel in 2011 (see also Appendix 3.1, Table 17).

_Business strategy_

3.39. Go-Ahead told us that instead of a single national ‘Go-Ahead’ brand, the group adopted a ‘local branding’ approach using the names of its local operating companies which customers were familiar with. Go-Ahead told us that its operating companies largely provide services independently of each other. This was because Go-Ahead saw the market for public transport as a local business and passengers wanted a ‘brand that they understood’.

3.40. Go-Ahead stated that its acquisition strategy was focused on identifying high-density urban areas with an incumbent operator with a strong local brand, as demonstrated by its acquisitions of Plymouth Citybus and Konectbus.

_Mid-Sized Non-Municipal Operators_

3.41. For each Mid-Sized Non-Municipal Operator presented below, we include a map of its local bus operations in the reference area in Appendix 3.1.

_Transdev_

3.42. Headquartered in Paris, Transdev SA is a French transport operator providing a broad range of transport services including bus, coach, train and ferry services across seven European countries and in Australia and Canada. In 2008, Transdev SA generated total consolidated revenues of around €3.3 billion. Transdev SA operates in the UK through its wholly-owned subsidiary, Transdev plc (Transdev), which serves as a holding company for its various trading subsidiaries in the UK.

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6 Since the completion of the merger between Veolia Transport SA and Transdev represents a recent development and we received separate data from each of Veolia and Transdev, we have set out separate descriptions for each operator in this section.
Transdev also owns an 18 per cent equity stake in the municipal local bus operator NCT, with which Transdev operates and maintains the Nottingham Express Transit tram network.

3.43. The merger of Veolia Transport SA and Transdev SA was announced on 22 July 2009 and completed on 3 March 2011. The common organization structure for the new Veolia Transdev entity was implemented from September 2011.

**Local bus operations**

3.44. Prior to its merger with Veolia in March 2011, Transdev operated local bus services in the reference area through two principal subsidiaries: Bournemouth Transport Ltd (Bournemouth Transport) and Transdev Blazefield Ltd (Transdev Blazefield). Transdev told us that as part of the merger of Veolia and Transdev, Bournemouth Transport was sold to RATP, a state-owned French company responsible for public transportation in the Paris region. Transdev told us that RATP currently did not have any other deregulated operations in the UK, but intended to develop its UK presence. We received separate data from each of Veolia and Transdev. Therefore we have set out separate descriptions for each operator.

3.45. Within the reference area, Transdev’s UK local bus operations generated total revenues of around £70.7 million during its financial year ended 31 December 2010. A map of Transdev’s local bus operations in the reference area is shown in Appendix 3.1, Figure 1.

- **Bournemouth Transport**

3.46. Transdev acquired a 90 per cent equity stake in former Municipal Operator Bournemouth Transport in December 2005 (the remaining 10 per cent stake was retained by Bournemouth Borough Council). Based in Bournemouth, Dorset, with a fleet of around 130 buses which are operated out of a single depot, Bournemouth Transport operates local bus services in Bournemouth, Poole and Christchurch under the Yellow Buses brand and a number of franchised coach routes for National Express. For its financial year ended 31 December 2010, Bournemouth Transport generated total revenues of around £18.4 million, of which local bus revenues accounted for around £14.0 million (around 75 per cent of total revenues). Since its acquisition by RATP, the company has changed its name to Yellow Buses.

- **Transdev Blazefield**

3.47. Transdev Blazefield comprises six wholly-owned trading subsidiaries which are managed together as a single business. Transdev Blazefield operates a total fleet of 413 buses from its seven depots and provides local bus services in Greater Manchester, Lancashire and Yorkshire. For its financial year ended 31 December 2010, Transdev Blazefield generated total revenues of around £52.3 million, of which around £50 million was accounted for by local bus revenues.

**Business strategy**

3.48. Transdev told us that on urban services, it generally did not find that providing high-quality services or having strong brand recognition generated customer loyalty.

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9 Régie Autonome des Transports Parisiens.
Instead, one of the key benefits of providing a high-quality offering was to attract new passengers on to buses.

Veolia

Group overview

3.49. Headquartered in Paris and listed on both the Euronext exchange and the New York Stock Exchange, with a current market capitalization of around €5.1 billion, Veolia Environnement SA (Veolia SA) is a multinational conglomerate with operations in water supply and management, waste management, energy, and transport services. Veolia SA’s transport division, Veolia Transport SA, operates an international rail and bus business across 28 countries, and for its financial year ended 31 December 2010 generated revenues of around €5.8 billion (around 17 per cent of group revenues). The merger of Veolia Transport SA and Transdev SA was announced on 22 July 2009 and completed on 3 March 2011 (see paragraph 3.43).

Local bus operations

3.50. Veolia Transport SA operates in the UK through its wholly-owned subsidiary Veolia Transport UK Ltd (Veolia UK), which provides bus and coach services in the Midlands, the North-East of England and South Wales. As of 28 February 2011, Veolia UK closed its Nottingham depot along with all of its local bus services for that geographical area, which it transferred to another local bus operator, Premiere Travel. The Treforest and Penclawdd depots were closed during May and June 2011. In July 2011, the Rotherham (North Eastern) depot was closed and more recently the Leicester operations were transferred to Roberts Coaches (Coalville and Hugglescote) and Centrebus East (Saxby depot) in October 2011. Veolia UK currently operates a combined bus and coach fleet of 590. For its financial year ended 31 December 2009, Veolia UK generated total revenues of around £[X] million. A map of Veolia’s local bus operations in the reference area as of October 2009 is shown in Appendix 3.1, Figure 2.

Business strategy

3.51. Veolia UK stated that in the UK its focus so far was largely on tendered local bus services as this was the business model adopted in its European and North American operations. However, Veolia UK said that it needed to focus more on commercial services in order to achieve higher returns.

Wellglade

Group overview

3.52. Headquartered in Heanor, Derbyshire, Wellglade Ltd (Wellglade) is the holding company for its wholly-owned trading subsidiaries providing local and non-local bus (eg private bus contract) services in Nottinghamshire, Derbyshire, the Loughborough area and South Yorkshire. Wellglade operates a total combined fleet of just over

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10 Since the completion of the merger between Veolia Transport SA and Transdev represents a recent development and we received separate data from each of Veolia and Transdev, we have set out separate descriptions for each operator in this section.
500 buses, and for its financial year ended 31 December 2009 generated total revenues of around £52.5 million.\(^\text{11}\)

**Local bus operations**

3.53. Wellglade operates its local bus services from six depots through its wholly-owned subsidiaries: Trent Motor Traction Company Ltd (Trent), Barton Buses Ltd (Barton), Nottinghamshire & Derbyshire Traction Company Ltd (Notts & Derby), Kinchbus Ltd (Kinchbus), TM Travel Ltd (TM Travel) and Midland General Omnibus Company Ltd (Midland General). A map of Wellglade’s local bus operations in the reference area is shown in Appendix 3.1, Figure 3.

- **Trent Barton**

3.54. The Trent and Barton subsidiaries operate under the common livery, Trent Barton, and provide local bus services in Nottinghamshire, Derbyshire and Leicestershire. The combined Trent Barton business operates a fleet of around 270 buses, and for its financial year ended 31 December 2009 generated total revenues of around £45.9 million of which local bus services accounted for around £45.1 million. The Trent Barton business accounts for around 87 per cent of Wellglade’s consolidated group revenues.

- **Notts & Derby**

3.55. With a total fleet of 74 buses, Notts & Derby provides local bus services in Nottinghamshire, Derbyshire and Leicestershire, as well as the Unibus bus service serving the University of Derby and the High Peak Campuses. For its financial year ended 31 December 2009, Notts & Derby generated total revenues of around £3.0 million, of which local bus services accounted for around £2.0 million.

- **Kinchbus**

3.56. Kinchbus operates a fleet of 31 buses and primarily serves the Loughborough area. For its financial year ended 31 December 2009, Kinchbus generated total revenues of around £3.4 million, of which £3.3 million was accounted for by its local bus services.

- **TM Travel and Midland General**

3.57. Acquired in January 2010, TM Travel operates a fleet of around 100 buses and provides tendered local bus services (as well as contract bus services) in Derbyshire, South Yorkshire and Nottinghamshire. Wellglade also owns Midland General, which operates low-cost services in the Nottingham area (Sutton and Mansfield) with a small fleet of 26 buses under the Bargain Bus and door2door brands. The Midland General services have been deployed on routes where Premiere Travel had entered the market against Trent Barton’s services.

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\(^\text{11}\) For its financial year ended 31 December 2010, Wellglade generated total revenues of £61.3 million and an operating profit of £6.9 million. Since we did not have the breakdown of Wellglade’s revenues for its different local bus operations for the 2010 financial year, we present Wellglade’s 2009 results above (source: Wellglade Annual Report for the financial year ended 31 December 2009 and 2010).
**Business strategy**

3.58. The Trent Barton business told us that it recognized it was going to remain a small group and therefore to succeed it needed to be a good ‘specialist operator’. It explained that it intended to stay focused on commercial services, where it would retain control of the routes, eg in terms of frequency, quality, etc.

**Rotala**

**Group overview**

3.59. Headquartered in Birmingham and listed on AIM, Rotala plc (Rotala) is an operator of bus and coach services with a current market capitalization of around £14.1 million. For its financial year ended 30 November 2010, Rotala generated total consolidated revenues of £44.6 million.

**Local bus operations**

3.60. With a fleet in excess of 500 buses, Rotala provides the majority of its local bus services through four subsidiary operating companies: Central Connect Ltd in the West Midlands; Diamond Bus Company Ltd in Worcestershire and the West Midlands; Flights Hallmark Ltd (under its trading name Wessex Connect) in the Bristol and Bath areas in the South-West; and Preston Bus Limited in Preston. Since starting its local bus operations in tendered services, Rotala’s expansion into commercial services came with its acquisition of Diamond Bus Ltd. On 25 January 2011, Rotala announced that it had acquired Preston Bus from Stagecoach. Preston Bus predominantly operates local bus services in and around Preston with a fleet of around 85 buses out of a single depot, and for its financial year ended 30 April 2010 generated total revenues of around £7.8 million. Rotala announced that Preston Bus gave Rotala ‘a significant expansion of its activities in a new geographical area. This area is approximately the same distance from Birmingham as the existing activities of the Company to the south west (in Bristol and Bath) and creates a new hub for the operations of the group’. A map of Rotala’s local bus operations in the reference area as of October 2009 is shown in Appendix 3.1, Figure 4.

**Business strategy**

3.61. Rotala told us that it had taken the opportunity to develop its commercial services where it had had the opportunity to be the sole operator of a route. However, given that such opportunities were limited in a mature market such as the West Midlands, Rotala now operates head-to-head with incumbent operators in order to grow market share.

**EYMS**

**Group overview**

3.62. Based in Hull and wholly owned by one shareholder who is also its Chairman and Chief Executive, EYMS is the holding company for three wholly-owned subsidiary bus and coach operators: East Yorkshire Motor Services Ltd (East Yorkshire Motor Services), Finglands Coachways Ltd (Finglands) and Whittle Coach and Bus Ltd
For its financial year ended 31 December 2009, EYMS generated total consolidated revenues of around £38.6 million.\textsuperscript{12}

Local bus operations

- **East Yorkshire Motor Services**

3.63. With a fleet of around 300 buses, East Yorkshire Motor Services provides local bus services out of its two depots to the areas of East Yorkshire and Scarborough. East Yorkshire Motor Services also provides a number of coach services with its fleet of 16 coaches and an additional eight in the National Express fleet. For its financial year ended 31 December 2009, East Yorkshire Motor Services generated total revenues of around £26.6 million (excluding coach revenues). A map of EYMS’s local bus operations in the reference area is shown in Appendix 3.1, Figure 5.\textsuperscript{13}

- **Finglands**

3.64. Finglands operates out of a single depot in South Manchester and provides local bus and coach services with a fleet of 47 buses and 10 coaches which are for private hire. For its financial year ended 31 December 2009, Finglands generated total revenues of around £4.4 million (excluding coach revenues).\textsuperscript{14}

- **Whittle**

3.65. Based in Kidderminster, Whittle operates a fleet of 19 buses and 14 coaches. It operates a network of local bus services in and around the Kidderminster, Bewdley and Stourport areas, with a regular service to Bridgnorth. For its financial year ended 31 December 2009, Whittle generated total revenues of around £1.1 million (excluding coach revenues).\textsuperscript{15}

Business strategy

3.66. EYMS told us that given the maturity of its business, there was very little capacity to expand its core offering into new areas without significant cost. EYMS stated that whilst acquisition opportunities existed, these tended to be outside its existing areas of operation.

\textsuperscript{12} EYMS statutory accounts for the financial year ended 31 December 2009. For its financial year ended 31 December 2010, EYMS generated total revenues of £37.5 million. Since we did not have a detailed split of local and non-local bus revenues for EYMS’s (and its subsidiaries’) latest financial year, we present above its financial results for its financial year ended 31 December 2009.

\textsuperscript{13} For its financial year ended 31 December 2010, East Yorkshire Motor Services generated total revenues of £29.6 million (including coach revenues). Given that we did not have a detailed split of its local and non-local bus revenues, we present above its financial results for its financial year ended 31 December 2009.

\textsuperscript{14} For its financial year ended 31 December 2010, Finglands generated total revenues of £5.0 million (including coach revenues). Since we did not have a detailed split of its local and non-local bus revenues, we present above its financial results for its financial year ended 31 December 2009.

\textsuperscript{15} For its financial year ended 31 December 2010, Whittle generated total revenues of £2.5 million (including coach revenues). Since we did not have a detailed split of its local and non-local bus revenues, we present above its financial results for its financial year ended 31 December 2009.
Mid-Sized Municipal Operators

Lothian Buses

Group overview

3.67. Headquartered in Edinburgh, Lothian Buses is the only remaining municipal operator in Scotland. The City of Edinburgh Council is its largest shareholder with a 91.01 per cent stake.

Local bus operations

3.68. Lothian Buses primarily provides local bus services in Edinburgh and the surrounding areas of Midlothian and East Lothian with a fleet of around 570 buses out of its three depots: Longstone, Annandale Street (Central) and Marine. For its financial year ended 31 December 2009, Lothian Buses' local bus operations generated around £109.9 million of revenue.16

Business strategy

3.69. Lothian Buses stated that given its 'social ownership' structure, profit-maximization and dividend return did not form its principal objectives. Instead, it stated that in respect of its strategy on fares and network/service planning, there was a substantial element of 'social dividend' considerations. Lothian Buses is also closely linked to the current construction and development of the Edinburgh Tram Network, which aims to provide Edinburgh with an 'integrated public transport network', where common signage and branding will apply to both buses and trams, and Lothian Buses' services will interchange with the trams at various locations. The construction of the Edinburgh Tram Network was overseen by tie Limited,17 until a restructuring of governance arrangements in autumn 2011 placed the project under direct City of Edinburgh Council management. It has faced significant delays and funding problems. Once the construction of the network is complete, Lothian Buses is expected to operate the tram network.18

Nottingham City Transport

Group overview

3.70. NCT is an operator of local bus and tram services.19 It was formed in 1986 under the 1985 Act, and is 82 per cent owned by Nottingham City Council with the remaining stake held by Transdev. For its financial year ended 27 March 2010, NCT generated total consolidated revenues of £50.8 million.20

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16 For its financial year ended 31 December 2010, Lothian Buses generated consolidated revenues of £112.6 million. We do not have a breakdown of its local bus operations’ revenues for its latest financial year.
17 tie Limited is a wholly-owned company of the City of Edinburgh Council.
18 Article from The Scotsman, 17 December 2010.
19 NCT’s tram services are provided through its 50 per cent interest in the unincorporated joint-venture Nottingham Tram Consortium (Transdev holds the remaining 50 per cent interest), which operates and maintains the Nottingham Express Transit tram network.
20 For its financial year ended 31 March 2011, NCT generated total revenues of £52.7 million. Since we did not have a detailed split of local and non-local bus revenues for NCT’s latest financial year, we present above its financial results for its financial year ended 27 March 2010.
Local bus operations

3.71. NCT focuses on the provision of local bus services out of its three depots (Parliament Street, Trent Bridge and Gotham) with a combined fleet of around 340 buses in the Greater Nottingham area, as well as providing daily local bus services between Nottingham and East Leake, Gotham, Loughborough and Southwell. NCT told us that it did not operate any rural services. NCT’s services operate under two main brands, which form its integrated local bus network: the GO2, a high-frequency service serving ‘key arterial routes’ in Arnold, West Bridgford, Bulwell and other specific areas of the city; and the Nottingham Network, which generally operates less frequent services, serving the local housing estates. For its financial year ended 27 March 2010, passenger and concessionary revenues (ie excluding joint-venture and miscellaneous revenues) were £43.2 million.

Business strategy

3.72. NCT stated that the company pursued a social dividend through its ‘twin objectives’ of social inclusion and the provision of supported local bus services, which needed to be balanced with the company’s need to generate sufficient returns to meet the objectives of the business and its shareholders. NCT also added that one of its stated objectives had been to ‘play a pivotal role’ in the Nottingham Express Transit project (including Phase 2 of its development), highlighting that the ‘future of [Nottingham Express Transit] is also key to the future prospects of the Group’. NCT recently told us, however, that it had been unsuccessful in its bid to develop Phase 2 of the tram network. The successful bidder was Tramlink Nottingham.

Cardiff Bus

Group overview

3.73. Headquartered in Sloper Road, Cardiff, Cardiff Bus was created following the deregulation of the UK local bus market and is wholly owned by the County Council of the City and County of Cardiff. Cardiff Bus predominantly operates local bus services, and for its financial year ended 31 March 2009 generated total revenues of £32.1 million.

Local bus operations

3.74. With a total fleet of 236 buses, Cardiff Bus operates throughout Cardiff predominantly in its urban areas, covering Vale of Glamorgan and Newport out of its single depot based in Sloper Road. Cardiff Bus told us that it operated a comprehensive network across the areas it served.

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21 Nottingham Express Transit is a light-rail tramway in the Nottingham area.

22 A press release dated 29 March 2011 from Nottingham City Council announced: ‘To ensure the extended tram network’s operation is fully integrated with the existing Line One, the contract with the consortium currently operating Line One, Arrow Light Rail, will be terminated’.

23 Cardiff Bus’s latest annual report is for the financial year ended 31 March 2010, where it generated total revenues of £32.2 million and an operating profit of £1.0 million. Since we did not have a breakdown of Cardiff Bus’s local bus revenues for its latest financial year, we present above its results for the financial year ended 31 March 2009.
Business strategy

3.75. Cardiff Bus told us that [3]. Cardiff Bus stated that the pursuit of the ‘social and financial dividend’ did not restrict its operations and that it was able to focus on generating sufficient cash flows for future investment, asset replacement and managing the business.

Reading Transport

Group overview

3.76. Reading Transport was incorporated in 1986 under the 1985 Act and is wholly owned by Reading Borough Council. Reading Transport provides local bus services within the greater Reading and Newbury areas, as well as a number of private contract bus services. For its financial year ended 4 October 2009, Reading Transport generated total revenues of around £26.2 million (of which local bus revenues accounted for around £21.0 million).

Local bus operations

3.77. Reading Transport operates a total fleet of 140 buses out of its sole depot in Reading and its one outstation in Newbury (both in Berkshire). Reading Transport operates local bus services under the brands Reading Buses and Newbury Buses. Reading Buses predominantly operates urban local bus services in Reading, where routes are branded ‘Premier Routes’, alongside some rural and late-night services. Newbury Buses used to provide tendered local bus services in Newbury and its surrounding areas, as well as a network of contract bus services for Vodafone, but since 30 August 2011, the Newbury Buses division has ceased to operate tendered and commercially-operated local bus services.

Business strategy

3.78. Reading Transport told us that over the five-year period to 2009, its operations had been fairly stable with no major changes to its network, and it explained that constant changes to its network were ‘destabilizing of local life’ and unpopular with its users and Reading Borough Council, its shareholder.

Blackpool Transport

Group overview

3.79. Headquartered in Rigby Road, Blackpool, Blackpool Transport was set up under the 1985 Act as an arm’s-length company to Blackpool Borough Council (its sole shareholder), and provides bus and tram services. For its financial year ended 29 March

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24 For its financial year ended 3 October 2010, Reading Transport generated total revenues of £25.6 million. Since we did not have the proportion of revenues accounted for by local bus services for its financial year ended 3 October 2010, we present above its results for its financial year ended 4 October 2009.

25 Reading Transport told us that this action was taken following the loss of two tendered services operated by the Newbury Buses division and its predecessor operators since around 1925.
2009,\textsuperscript{26} Blackpool Transport generated total revenues of around £24.6 million, of which its local bus operations accounted for £21.1 million.\textsuperscript{27}

\textit{Local bus operations}

3.80. With a fleet of around 140 buses under the Blackpool Transport brand, Blackpool Transport operates its local bus services in the urban areas (eg Blackpool) of Lancashire’s Fylde Coast.

\textit{Business strategy}

3.81. Blackpool Transport told us that it did not set itself any specific route profitability hurdle rates, and given its ‘set-up’, it was ‘under pressure’ from its shareholder to provide a network of services in the community which involved a ‘significant social dividend’, where certain services were being cross-subsidized.

\textsuperscript{26} Blackpool Transport generated total revenues of £23.1 million for the financial year ended 28 March 2010 (source: Blackpool Transport Annual Report). The statutory accounts report Blackpool Transport’s like-for-like prior year revenues (ie for the financial year ended 29 March 2009) at £24.6 million. We have not reported 2010 figures given that we did not have the breakdown of its local bus revenue figures.

\textsuperscript{27} For its financial years ended 31 March 2010 and 2011, Blackpool Transport generated total revenues of £23.1 million and £20.8 million respectively (source: Blackpool Transport Annual Reports). Since we do not have the breakdown of its local bus revenue figures for the financial year ended 28 March 2010, we present above its financial results for the financial year ended 29 March 2009.
4. Local bus industry structure

Introduction

4.1 In Section 2 we set out the structure of the local bus industry in the reference area taken as a whole. We described the different types of suppliers of local bus services and the size of their operations. We found that more than 1,000 local bus operators are active in the reference area.

4.2 However, of these operators about half are active in just one LTA. Of those operators which are active in more than one LTA, the great majority are active only in a single group of physically adjacent LTAs. Even the largest bus companies do not operate everywhere within the reference area—Stagecoach, FirstGroup and Arriva operate one or more bus routes in 72, 62 and 56 per cent of LTAs respectively. In sum, the operations of most bus companies are focused in particular localities.

4.3 This creates the potential for the structure of supply of local bus services to vary substantially from one local area to the next. It is the local structure of the bus industry that we examine in this section.

4.4 In particular, we consider the number of operators and the relative size of their operations in different local areas and consider how this varies across the reference area. We use two different geographic levels in our assessment:

- first we consider the share of supply of the largest operator(s) and overall number of operators at the level of LTAs (paragraph 4.6 to 4.10); and
- second we introduce our preferred geographic unit of analysis, that of Urban Areas, and consider the share of supply of the largest operator(s) and the overall number of operators in each Urban Area in the reference area (paragraph 4.11 to 4.33).

4.5 Our conclusions on local concentration in the bus industry are set out in paragraphs 4.34 to 4.38.

The structure of local bus operations at the LTA level

4.6 As the administrative regions across which local transport policy is determined (see paragraph 2.69), LTAs provide a natural starting point for considering the structure of bus operations in local areas. Table 4.1 presents some summary statistics for the number of operators in each LTA, as well as the average share of supply of the operator(s) with the highest share of supply in each LTA.

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1 Information on the number of LTAs served by each operator has been calculated using the Traveline data set, which is the main data source used throughout this section—see Appendix 4.1 for more information on this data set and how it has been prepared.
TABLE 4.1  Summary statistics for the number of operators in each LTA, and the share of all local bus services operated by the largest one, two and three operators in that LTA

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of operators with any services in the LTA</td>
<td>20.4</td>
<td>15</td>
<td>2</td>
<td>83</td>
</tr>
<tr>
<td>Number of operators with a share of supply of at least 10% in the LTA</td>
<td>2.0</td>
<td>2</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Share of supply of the largest operator in the LTA (%)</td>
<td>60.3</td>
<td>59.0</td>
<td>21.5</td>
<td>99.3</td>
</tr>
<tr>
<td>Combined share of supply of the two largest operators in the LTA (%)</td>
<td>79.4</td>
<td>81.0</td>
<td>30.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Combined share of supply of the three largest operators in the LTA (%)</td>
<td>85.9</td>
<td>88.6</td>
<td>36.3</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CC analysis of Traveline data for October 2009.

Note: An operator’s share of supply in an area is measured throughout this section as the total number of weekly services (i.e., number of scheduled journeys) run by that operator on local bus routes which cover a distance of at least 500 metres in an area, divided by the total number of weekly services on local bus routes run by all operators which cover a distance of at least 500 metres in the area (we restrict our attention to routes that cover a distance of at least 500 metres in an area in order to exclude routes that only have a very marginal presence in an Urban Area). The measure will closely correspond to the relative share of journeys in an area which are served by a given operator. Using the total number of services to calculate shares of supply will not take into account the actual number of passengers carried on each route, the length of a route, or the capacity of the vehicles running on a route. Nevertheless, it is the best and most complete indicator of route passenger volumes which is available.

4.7 The table shows that, on average, an LTA has around 20 operators. Generally, these consist of a small number of operators (one or two) with a substantial share of supply, and then a longer tail of operators with a low share of supply in the LTA. Almost 80 per cent of LTAs have no more than two operators with an individual share of supply of 10 per cent or more.

4.8 The information presented in the lower part of Table 4.1 shows that, on average, the largest operator in an LTA runs a large share of total weekly services, and that generally the great majority of local bus services in an LTA are run by the two or three largest operators in an LTA. In almost 30 per cent of LTAs, the largest operator has a share of supply of 70 per cent or more.2

4.9 The degree to which local bus services are concentrated in the hands of a small number of operators varies substantially across LTAs. Of the 132 LTAs in the reference area, we find two LTAs where the three operators with the highest shares of supply in the area run in total less than 50 per cent of all services, and three areas where the operator with the highest share of supply in the area runs over 95 per cent of all services. The total number of operators running any local bus routes in an LTA ranges from two (Orkney Islands, Isle of Wight) to over 80 (Lancashire). Figure 4.2 shows the share of supply of the operator with the highest share of supply in different LTAs in the reference area. Darker colours indicate that a greater share of all local bus services is operated by the bus company with the largest operations in the LTA (London is outside the reference area).

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2 This finding is based on the distribution underlying the results set out in Table 4.1.
FIGURE 4.1

The share of supply of the largest operator in each LTA

4.10 LTAs where the largest operator runs the vast majority of local bus services cover both urban (eg Milton Keynes) and rural areas (eg Highland). As the figure shows, highly concentrated authorities of this type are particularly prevalent in Scotland.
LTAs where the largest operator runs a relatively lower proportion of all local bus services (less than 40 per cent) are found throughout the reference area, and cover urban areas (e.g., Greater Manchester), rural areas (e.g., Powys), and both northern (e.g., North Yorkshire) and southern counties (e.g., Surrey).

**The structure of local bus operations at the Urban Area level**

4.11 LTAs sometimes cover large geographical areas and their borders reflect administrative boundaries, rather than the shape of local bus networks. In some cases, they will contain more than one city or town which might be considered to have its own network of local bus services. In other cases a single local bus network may span more than one LTA. Because of this, we also considered an alternative geographic level in our analysis, that of ‘Urban Areas’—cities or towns (or groups of nearby cities or towns) and their nearby suburbs which have a highly interconnected bus network that is in some sense distinct from the wider bus network.

4.12 We grouped together nearby settlements with highly interconnected bus networks into 239 such Urban Areas. The full methodology used to construct these areas—setting out how groups of towns with a relatively distinct network of local bus services were identified—is set out in Appendix 4.2. A full list of the names of the settlements contained within each Urban Area, and some illustrated examples of the areas, are given as annexes to the appendix.

4.13 Around 92 per cent of all routes in the reference area pass through one of these Urban Areas (after weighting routes by their total weekly frequency), and the Urban Areas which we have defined account for 70 per cent of the total population of the reference area.\(^3\) The average population of an Urban Area in our data set was approximately 145,000.\(^4\)

4.14 Our assessment of concentration in Urban Areas is organized as follows. First we consider shares of supply and the number of operators in all Urban Area in the reference area taken together (see paragraphs 4.15 to 4.24). Second we look more closely at concentration in the largest Urban Areas (see paragraphs 4.25 to 4.29). Third we consider the presence of the Large Operators in each Urban Area (see paragraphs 4.30 and 4.31). Fourth we evaluate concentration in rural parts of the reference area that are not covered by our Urban Areas (see paragraphs 4.32 and 4.33).

**Concentration in all Urban Areas**

4.15 Table 4.2 presents some summary statistics on the average number of operators in an Urban Area, and the average share of supply of the operator(s) with the highest share of supply in each area. It shows that, on average, an Urban Area has about half as many operators as an LTA—just under ten. The profile of these operators is similar to that at the level of LTAs (see paragraph 4.7)—in general, an Urban Area will have a number of bus companies with small operations in the area, and then one or two operators with a substantial share of supply. On average, an Urban Area has around two local bus operators which each operate 10 per cent or more of all local bus services in the area.

\(^3\) We would expect some people living in the areas surrounding Urban Areas to use local bus services which pass through the Urban Areas, and these individuals will not be included in this figure.

\(^4\) Population data taken from Office for National Statistics (ONS) and General Register Office for Scotland (GROS) Census 2001 data.
TABLE 4.2  Summary statistics for the number of operators in each Urban Area (UA), and the share of all local bus services operated by the largest one, two and three operators in that area

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of operators</td>
<td>9.7</td>
<td>9</td>
<td>1</td>
<td>42</td>
</tr>
<tr>
<td>Number of operators with a share of supply of at least 10%</td>
<td>1.9</td>
<td>2</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Share of supply of largest operator in the UA (%)</td>
<td>68.8</td>
<td>67.5</td>
<td>24.8</td>
<td>100.0</td>
</tr>
<tr>
<td>Combined share of supply of two largest operators in the UA (%)</td>
<td>86.4</td>
<td>88.3</td>
<td>40.7</td>
<td>100.0</td>
</tr>
<tr>
<td>Combined share of supply of three largest operators in the UA (%)</td>
<td>92.6</td>
<td>94.1</td>
<td>54.9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CC analysis of Traveline data for October 2009.

4.16  These averages conceal a great degree of variation between different Urban Areas. The number of active operators (as recorded in the Traveline database at October 2009) differs substantially, ranging from one operator in Barrow-in-Furness, to 42 operators in Birmingham and Glasgow. The full distribution of the number of operators in the Urban Areas is shown in Figure 4.2. It shows that the majority of areas have fewer than ten operators.

FIGURE 4.2

Histogram showing the distribution of the number of operators operating local bus routes in the Urban Areas

Source: CC analysis of Traveline data for October 2009.

4.17  In a typical area, a large proportion of all local bus services are served by a single operator (looking across the Urban Areas, the average share of the largest operator is 69 per cent). However, although almost all areas are highly concentrated, the extent to which the operation of local bus services is concentrated in the hands of the largest bus company varies significantly between Urban Areas.

4.18  Table 4.2 shows that the proportion of all local bus services operated by the operator with the highest share of supply in an Urban Area ranges from approximately 25 per
cent (in Bury St Edmunds) to 100 per cent (in Barrow-in-Furness). In a substantial proportion of areas a single operator controls the great majority of all local bus services—the largest operator in an Urban Area has a share of supply of above 90 per cent in 32 Urban Areas (13 per cent of all areas), above 80 per cent in 66 Urban Areas (28 per cent of all areas) and above 75 per cent in 92 Urban Areas (38 per cent of all areas). At the same time, there are also a number of areas where the largest operator controls a smaller share of supply—the largest operator in an Urban Area has a share of supply of below 50 per cent in 38 Urban Areas (16 per cent of all areas). The full distribution across the Urban Areas of the share of supply of the operator with the highest share of supply in each area is shown in Figure 4.3.

**FIGURE 4.3**

The distribution across Urban Areas of the share of supply of the largest operator in the area

Source: CC analysis of Traveline data for October 2009.

4.19 To further illustrate the distribution of the largest operators’ shares of supply across Urban Areas, we plotted the share of supply of the largest operator in each Urban Area against that of the second largest operator. Figure 4.4 shows these shares of supply for each Urban Area. Also shown on the graph is the combined share of the two largest operators.
4.20 The figure shows that, as set out in paragraphs 4.17 and 4.18 above, in many areas, the largest operator runs a very high proportion of all local bus services. The 92 areas where the largest operator has a share of supply of 75 per cent or more are illustrated in red—along with the 75 per cent threshold—in Figure 4.5.
4.21 There are a further group of areas where the second largest operator also runs a substantial share of supply and together these operators account for most of total supply. For example, there are 87 Urban Areas (36 per cent of all areas) where the largest operator runs less than three-quarters of all local bus services in the area, the second largest operator runs more than 15 per cent of all local bus services, and together the two largest operators control at least three-quarters of all local bus services. These areas are illustrated in red in Figure 4.6.
FIGURE 4.6

Urban Areas where the second largest operator has a share of supply in excess of 15 per cent and the largest and second largest operators collectively account for 75 per cent of supply

Source: CC analysis of Traveline data for October 2009.

4.22 In the remainder of areas, supply is divided between a greater number of operators, with the largest operator accounting for a different share of services depending on the area. These are generally the very largest or the very smallest areas in terms of population.

4.23 Appendix 4.3 provides a complete table of the largest three operators and their shares of supply in all 239 Urban Areas, as well as some additional details about the areas.

4.24 Table 4.3, adapted from the appendix, shows the five Urban Areas where the largest operator runs the highest proportion of total services in that area, and the five Urban Areas where the largest operator runs the lowest proportion of total services. The difference in the structure of the local bus operation in the two sets of areas further illustrates the extent of variation in concentration between Urban Areas.
TABLE 4.3  The five Urban Areas where the largest operator in an Urban Area operates the highest and lowest share of supply

<table>
<thead>
<tr>
<th>Urban Area</th>
<th>Population</th>
<th>No of operators</th>
<th>Largest operator</th>
<th>Share of supply %</th>
<th>Second largest operator</th>
<th>Share of supply %</th>
<th>Third largest operator</th>
<th>Share of supply %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barrow</td>
<td>65,410</td>
<td>1</td>
<td>Stagecoach</td>
<td>100.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kirkcaldy</td>
<td>55,197</td>
<td>2</td>
<td>Stagecoach</td>
<td>99.6</td>
<td>Fisher Tours</td>
<td>0.4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grimsby</td>
<td>148,211</td>
<td>5</td>
<td>Stagecoach</td>
<td>99.3</td>
<td>Amvale</td>
<td>0.5</td>
<td>Holloway Coaches</td>
<td>0.1</td>
</tr>
<tr>
<td>Ardrossan</td>
<td>31,341</td>
<td>2</td>
<td>Stagecoach</td>
<td>99.1</td>
<td>Shuttlebus</td>
<td>0.9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Irvine</td>
<td>54,334</td>
<td>2</td>
<td>Stagecoach</td>
<td>98.6</td>
<td>Shuttlebus</td>
<td>1.4</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**The five Urban Areas where the largest operator has the highest share of supply**

**The five Urban Areas where the largest operator has the lowest share of supply**

<table>
<thead>
<tr>
<th>Urban Area</th>
<th>Population</th>
<th>No of operators</th>
<th>Largest operator</th>
<th>Share of supply %</th>
<th>Second largest operator</th>
<th>Share of supply %</th>
<th>Third largest operator</th>
<th>Share of supply %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bury St Edmunds</td>
<td>37,730</td>
<td>14</td>
<td>FirstGroup</td>
<td>24.8</td>
<td>Mulleys Motorways</td>
<td>15.9</td>
<td>H C Chambers &amp; Son</td>
<td>14.3</td>
</tr>
<tr>
<td>Bicester</td>
<td>31,113</td>
<td>8</td>
<td>Grayline Coaches</td>
<td>28.9</td>
<td>Arriva</td>
<td>27.6</td>
<td>R H Transport</td>
<td>24.9</td>
</tr>
<tr>
<td>Chippenham</td>
<td>33,189</td>
<td>9</td>
<td>Fosseway Coaches</td>
<td>30.1</td>
<td>FirstGroup</td>
<td>24.0</td>
<td>Stagecoach</td>
<td>20.7</td>
</tr>
<tr>
<td>Borehamwood</td>
<td>32,967</td>
<td>6</td>
<td>Uno</td>
<td>34.6</td>
<td>Sullivan Buses</td>
<td>24.6</td>
<td>Arriva</td>
<td>21.3</td>
</tr>
<tr>
<td>Hinckley</td>
<td>63,316</td>
<td>9</td>
<td>Stagecoach</td>
<td>37.9</td>
<td>Centrebus</td>
<td>35.1</td>
<td>Arriva</td>
<td>15.9</td>
</tr>
</tbody>
</table>

Source: Share of supply data from CC analysis of Traveline data for October 2009, population data from ONS/GROS Census 2001 statistics.

Concentration in large Urban Areas

4.25  In general, both the most concentrated and the least concentrated Urban Areas which are set out in Table 4.3 have populations which are relatively small compared with the average. There is substantial variation in the size of the Urban Areas in the reference area. The 30 Urban Areas with the largest populations account for nearly half the population in all Urban Areas in the reference area.5

4.26  Table 4.4, again adapted from the full list of Urban Areas set out in Appendix 4.3, shows the ten largest Urban Areas, and the share of supply operated by the largest operators within these areas.

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5 These Urban Areas, in descending order of population, are Birmingham, Manchester, Glasgow, Liverpool, Leeds, Newcastle upon Tyne, Nottingham, Bristol, Sheffield, Leicester, Edinburgh, Bournemouth, Southampton, Bradford, Stoke-on-Trent, Birkenhead, Coventry, Cardiff, Portsmouth, Kingston upon Hull, Reading, Southend-on-Sea, Aldershot, Bolton, Wolverhampton, Blackpool, Plymouth, Sunderland, Brighton and Preston. Our definition of Urban Areas can include several adjacent centres of population—a full list of the towns associated with each Urban Area is included in Appendix 4.2, Annex B.
Table 4.4 The ten Urban Areas with the largest population in the reference area

<table>
<thead>
<tr>
<th>Urban Area</th>
<th>Population</th>
<th>No of operators</th>
<th>Largest operator</th>
<th>Share of supply %</th>
<th>Second largest operator</th>
<th>Share of supply %</th>
<th>Third largest operator</th>
<th>Share of supply %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Birmingham</td>
<td>1,846,211</td>
<td>42</td>
<td>National Express</td>
<td>76.4</td>
<td>Rotala</td>
<td>12.3</td>
<td>Choice Travel</td>
<td>2.2</td>
</tr>
<tr>
<td>Manchester</td>
<td>1,622,279</td>
<td>39</td>
<td>Stagecoach</td>
<td>42.0</td>
<td>FirstGroup</td>
<td>32.0</td>
<td>Arriva</td>
<td>7.4</td>
</tr>
<tr>
<td>Glasgow</td>
<td>1,032,877</td>
<td>42</td>
<td>FirstGroup</td>
<td>54.3</td>
<td>Arriva</td>
<td>13.3</td>
<td>Stagecoach</td>
<td>3.9</td>
</tr>
<tr>
<td>Liverpool</td>
<td>894,297</td>
<td>29</td>
<td>Arriva</td>
<td>60.8</td>
<td>Stagecoach</td>
<td>17.8</td>
<td>Huyton Travel</td>
<td>4.2</td>
</tr>
<tr>
<td>Leeds</td>
<td>827,220</td>
<td>13</td>
<td>FirstGroup</td>
<td>65.6</td>
<td>Arriva</td>
<td>26.1</td>
<td>Transdev</td>
<td>4.8</td>
</tr>
<tr>
<td>Newcastle upon Tyne</td>
<td>775,019</td>
<td>23</td>
<td>Go-Ahead</td>
<td>48.9</td>
<td>Stagecoach</td>
<td>28.0</td>
<td>Arriva</td>
<td>20.0</td>
</tr>
<tr>
<td>Nottingham</td>
<td>666,318</td>
<td>25</td>
<td>NCT</td>
<td>58.8</td>
<td>Wellglade</td>
<td>29.1</td>
<td>Premiere Travel</td>
<td>2.9</td>
</tr>
<tr>
<td>Bristol</td>
<td>577,098</td>
<td>24</td>
<td>FirstGroup</td>
<td>77.3</td>
<td>Rotala</td>
<td>16.8</td>
<td>ABUS</td>
<td>1.3</td>
</tr>
<tr>
<td>Sheffield</td>
<td>531,027</td>
<td>15</td>
<td>FirstGroup</td>
<td>67.9</td>
<td>Stagecoach</td>
<td>15.7</td>
<td>Wellglade</td>
<td>8.1</td>
</tr>
<tr>
<td>Leicester</td>
<td>475,359</td>
<td>16</td>
<td>Arriva</td>
<td>49.0</td>
<td>FirstGroup</td>
<td>31.4</td>
<td>Centrebus</td>
<td>8.5</td>
</tr>
</tbody>
</table>

Source: Share of supply data from CC analysis of Traveline data for October 2009, population data from ONS/GROS Census 2001 statistics.

4.27 Table 4.5 summarizes the extent of concentration in the largest Urban Areas. On average, these Urban Areas have a greater number of operators than smaller areas. The table shows that the average share of supply of the largest operator in these 30 areas is lower than in other Urban Areas in the reference area—at 63 per cent, compared with 70 per cent in the remaining 90 per cent of Urban Areas with a population of less than 250,000.

Table 4.5 Summary statistics for the number of operators in the largest 30 Urban Areas (UAs), and the share of all local bus services operated by the largest one, two and three operators in those areas

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of operators</td>
<td>17.67</td>
<td>14</td>
<td>4</td>
<td>42</td>
</tr>
<tr>
<td>Number of operators with a share of supply of at least 10%</td>
<td>1.93</td>
<td>2</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Share of supply of largest operator in the UA (%)</td>
<td>62.8</td>
<td>61.1</td>
<td>42.0</td>
<td>88.4</td>
</tr>
<tr>
<td>Combined share of supply of two largest operators in the UA (%)</td>
<td>85.8</td>
<td>88.2</td>
<td>67.6</td>
<td>100.0</td>
</tr>
<tr>
<td>Combined share of supply of three largest operators in the UA (%)</td>
<td>91.7</td>
<td>93.7</td>
<td>71.5</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: CC analysis of Traveline data for October 2009.

4.28 We note that these aggregate shares of supply may conceal a non-uniform distribution of operators’ networks within each area—for instance, in Manchester, where Stagecoach operates the majority of services in the south of the Urban Area, FirstGroup the majority of services in the north of the Urban Area. The implication of this is that concentration measured at the level of the Urban Area may mask substantial differences in concentration in different parts of that Urban Area.

4.29 Transport for Greater Manchester and Nexus raised the point that shares of supply can be misleading in their responses to our provisional findings. In particular, Transport for Greater Manchester suggested that, if Manchester were split into a northern and southern section, the market shares of Stagecoach and FirstGroup would be considerably higher than those shown in Appendix 4.3.6 In its response

See Transport for Greater Manchester response to provisional findings, paragraph 2.6.
hearing, Nexus told us that the Newcastle-upon-Tyne Urban Area that we had
categorized was large, and that because of this, shares of supply at the Urban Area
level did not reflect the extent of operator’s services in the different areas making up
the Urban Area. In particular it gave the example of Newcastle itself where
Stagecoach was the major operator and Go North East was a more marginal player.

*Presence of the Large Operators in Urban Areas*

4.30 Appendix 4.3 also shows the number of Large Operators with a share of supply of
10 per cent or more in each Urban Area. This information was used to consider the
distribution of the Large Operators across the Urban Areas, and in particular the
extent to which they are active within the same areas.

4.31 At least one of the Large Operators operates in nearly every Urban Area in the
reference area. Only two Urban Areas (Bridlington and Harrogate/Knaresborough)
are not served by any routes operated by a Large Operator, and there are only
14 Urban Areas (6 per cent) where none of these operators has a share of supply of
at least 10 per cent. However, as with LTAs, the Large Operators tend to operate in
separate areas, and it is relatively uncommon for more than one of them to have a
share of supply of more than 10 per cent in the same Urban Area. In 70 per cent of
Urban Areas only a single Large Operator has a share of supply of 10 per cent or
more. In sum, although active throughout the reference area, it is relatively rare for
the operations of the Large Operators to overlap substantially.

*Concentration in rural areas*

4.32 Although the Urban Areas discussed in this section cover the majority of the popu-
lation and the majority of bus services in the reference area, some rural areas will not
be covered by the preceding analysis. In order to understand whether the degree of
concentration in rural areas may differ from that in the rest of the reference area, we
considered the structure of the local bus industry in low population density local
authorities.7 Table 4.6 shows some summary statistics for authorities within the
bottom 25 per cent in terms of population density.

| TABLE 4.6  | Summary statistics for the number of operators, and the share of all local bus services operated by the
<table>
<thead>
<tr>
<th></th>
<th>largest one, two and three operators, in the 86 local authorities with the lowest population density</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mean</strong></td>
<td><strong>Minimum</strong></td>
</tr>
<tr>
<td>Population</td>
<td>91,634</td>
</tr>
<tr>
<td>Area (in hectares)*</td>
<td>187,546</td>
</tr>
<tr>
<td>Population density (population per hectare)</td>
<td>0.7</td>
</tr>
<tr>
<td>Number of operators</td>
<td>15.1</td>
</tr>
<tr>
<td>Number of operators with a share of supply of at least 10%</td>
<td>2.3</td>
</tr>
<tr>
<td>Share of supply of largest operator (%)</td>
<td>56.2</td>
</tr>
<tr>
<td>Combined share of supply of two largest operators (%)</td>
<td>73.8</td>
</tr>
<tr>
<td>Combined share of supply of three largest operators (%)</td>
<td>82.4</td>
</tr>
</tbody>
</table>

*For comparison, the average area of an Urban Area is 3,830 hectares, the maximum (in Birmingham) is 48,463 hectares.

4.33 Compared with Urban Areas—equivalent statistics for which are set out in Table
4.2—there is evidence that, on average, rural local authorities have a greater number

7 The local authorities referred to here relate to the 346 unitary authorities, metropolitan boroughs and district councils in the
reference area, and are distinct from the LTAs which are discussed earlier in this section (although in some instances the two
types of area will coincide).
of operators and have bus services which are less concentrated in the hands of single operator. This may be due to the much larger geographic area covered by rural local authorities (on average, a rural authority covers nearly 190,000 hectares compared with nearly 4,000 hectares for an average Urban Area). If supported services are more likely than commercial services to be operated by a range of different smaller operators, then another possible explanation might be that a greater number of services in rural areas are supported.

Conclusions on local bus industry structure

4.34 We draw several conclusions about the local structure of the bus industry based on the analysis set out in this section.

4.35 First, we found that local areas are, on average, highly concentrated, with only a small number of operators with significant shares of supply. For example, looking across the Urban Areas, the largest operator runs, on average, 69 per cent of local bus services on all routes in an area, the average proportion run by the two largest operators is 86 per cent, and generally only one or two bus companies operate a share of total weekly services of 10 per cent or more. Furthermore, the largest operator in an Urban Area has a share of supply of above 90 per cent in 32 Urban Areas (13 per cent of all areas), above 80 per cent in 66 Urban Areas (28 per cent of all areas) and above 75 per cent in 92 Urban Areas (38 per cent of all areas).

4.36 Second although most areas are highly concentrated, we found there to be substantial variation in the extent of concentration across different areas. The proportion of total weekly services that is run by the largest operator in an Urban Area ranges from 25 per cent in Bury-St-Edmunds to 100 per cent in Barrow-in-Furness.

4.37 Third, although active throughout the reference area, it is relatively rare for the operations of the Large Operators to overlap substantially.

4.38 Finally, we found evidence that rural local authorities have a greater number of operators and have bus services which are less concentrated in the hands of single operator than Urban Areas. Notwithstanding this, rural areas are also highly concentrated—in a typical rural local authority the largest operator runs 56 per cent of all weekly services.
5. **Customer demand**

5.1 This section focuses on customer demand for local bus travel. This is important in assessing the constraints on local bus operators, and interpreting our observations of how bus operators compete (see, in particular, Sections 7 and 8).

5.2 We begin by setting out two pieces of analysis we commissioned to assess the demand for bus travel. First, we set out an econometric study of demand (the econometric demand study),¹ using data from the National Travel Survey (NTS). Second, we set out our customer survey.² We then set out our analysis of key characteristics of customer demand for local bus services, namely: the factors that are important to customers in choosing whether to use the bus; customer switching between different operators; and how customers use the network of bus services in an area. In this analysis, as well as our customer survey and the econometric demand study, we draw on a broad range of evidence, including evidence from the local bus operators, the NTS and research by the DfT and Passenger Focus.

5.3 The econometric demand study and the consumer survey both also allow us to measure the responsiveness of overall demand for bus travel to small changes in the price (or other aspects of service) of bus travel. This is particularly important for the analysis of the scope of the relevant markets in Section 7.

**Econometric demand study**

5.4 The econometric demand study uses econometric techniques to analyse the demand for bus travel based on data on individuals’ travel patterns from the NTS. The NTS is a nationwide survey on detailed travel habits of more than 20,000 individuals in Great Britain.³

5.5 The NTS has information on each survey respondent’s travel behaviour, including the prices paid for the journeys they make, and a large set of demographic information. This allows an analysis of how demand for bus travel is affected by characteristics of travel such as price, the time of day, the frequency of service and journey time, as well as the characteristics of an individual. More detail on the methodology for this econometric demand study is found in the published study.⁴

5.6 The results of the econometric demand study describe the overall demand for bus travel. The study was used to generate market-level elasticities for the overall demand for bus travel. However, the data does not disaggregate to bus services at the level of an individual firm. Market-level elasticities also provide a useful insight into the demand conditions facing bus operators which do not face head-to-head competition from other suppliers of local bus services.

5.7 Broadly, the results of the econometric demand study are consistent with the findings of previous studies in this area. It found that the overall elasticity of bus demand, from all individuals in the sample, with respect to bus fares is –0.36. Furthermore, it found that, whilst the level of demand can vary quite a lot between different subgroups of individuals, the elasticity of demand for local bus services did not change much across a wide variety of sub-groups from the sample. This included disaggregating the sample by various classifications of passenger type, such as their income, age, walk time to bus stop, access to car or the frequency of their local bus service.

³ We have excluded data on London bus trips as this is outside our reference area.
No significant differences were found for the time of day, and no significant differences in the sensitivity of consumer demand with respect to fares were found for different city sizes, or for different regions of the reference area. For all of these groups the elasticity of demand was found to be smaller in magnitude than \(-0.5\).

5.8 These results suggest that while there are variations in demand between different groups of individuals, these are primarily variations in the levels of demand. We did not find significant differences in patterns of substitutability with other modes of transport between groups of individuals; for all groups, the willingness to substitute to other alternatives in response to a rise in fares is low. It is not practicable to measure the elasticity of demand directly in every local area because the NTS is not representative at a local level (for example, postcode sectors). However, the fact that no identifiable sub-group of individuals displays a high propensity to substitute to other alternatives to the bus suggests that it is highly unlikely that any local area will display a substantially higher propensity to substitute to alternative methods of transport or to no travel in response to an increase in fares. The elasticity of demand in a particular local area will be affected by the mix of individuals within that area; however, the evidence from the demand study suggests that whatever the mix the aggregate elasticity of demand faced by operators will be low.

5.9 Some of the operators noted that the demand study showed that there were individuals within the sample that displayed a high propensity to substitute to alternative methods of travel, or no travel, in response to an increase in fares and that this could mean that demand in specific local areas may be high.\(^5\) That there are some individuals who are particularly responsive to fare changes is to be expected in any market. What is important for the operators, and what will drive their behaviour, is the overall effect, ie how many passengers they will attract/lose with a fare decrease/increase.\(^6\) The demand study suggests that these individuals are few in number. It is possible that the most responsive individuals in the sample are concentrated into particular geographic areas. This would mean that the elasticity of demand in those areas would be higher in magnitude than \(-0.36\) and that the elasticity in the remaining areas would be lower in magnitude than \(-0.36\). We note that all of our attempts to assess groups of individuals systematically show that elasticities of demand are low no matter what group we look at. This suggests a random distribution of the most responsive individuals and we have no evidence to support the contention that there is any non-random pattern in the distribution of these individuals. In addition, because the average elasticity of demand is so low, and the number of particularly responsive individuals so few, we would need to observe an extremely geographically skewed distribution of the most responsive individuals to support an elasticity of demand for bus travel in any one area significantly greater in magnitude than \(-1\). We undertook some further analysis of the results of the econometric demand study and found no evidence that more responsive passengers were likely to be concentrated in particular geographic areas.\(^7\)

5.10 A number of the parties told us that it may take time for passengers to adjust their travel habits in response to changes in fares and other variables and so passengers might be more responsive, and would be more likely to substitute to other modes, over the longer term and that consequently short-term estimates of the elasticity of

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\(^5\) See Appendix 5.2.
\(^6\) If operators are able to distinguish between different categories of customers, there may be scope to price discriminate—for example, by offering student discounts.
\(^7\) See Appendix 5.2.
demand were of little practical relevance to the question of whether an increase in fares would be profitable.  

5.11 We note that there is no standard definition of short and long run for the purposes of demand analysis. The definition of ‘short run’ and ‘long run’ differs between studies and that many of the estimates labelled ‘short run’ in Appendix 7.3 consider relatively long time periods. For example, in The demand for Public Transport: A practical guide, 2004, chooses to define the short run as a period of one to two years, the medium term as five to seven years and the long run as 12 to 15 years.

5.12 We also note that long-run estimates of the responsiveness of demand to changes in fares are also low and consequently long run estimates of the elasticity of demand also point to a narrow market. As shown in Appendix 7.3, most estimates of long-run elasticities are smaller in magnitude than −1. Of the six long run estimates presented in Appendix 7.3 four are lower than -1 in magnitude. One study presents mixed results with an average long-run elasticity across countries of between −.23 and −1.19 and only one study presents elasticities that are greater than -1 in magnitude. This study, based on stated preference data, estimates elasticities for East Sussex only and estimates a long run price elasticity of −1.52.

5.13 The econometric demand study models how individuals make travel choices. In particular, it assesses how individuals make decisions with regard to their journey purpose, choice of their method of travel and their choice of ticket type. As such, the ‘short run’ for the purposes of this study is the time period over which individuals make these decisions. Certain decisions that might impact on an individual’s choice of method of travel are not modelled and are considered ‘fixed’. These decisions include factors like where an individual lives, their place of work, and whether they own a car or not. The ‘long run’ for the purposes of this study is therefore the time period over which these ‘fixed’ decisions become variable. If it were likely that an increase in bus fares would induce many passengers to move house, change jobs or purchase a car, then the elasticity estimates produced by the econometric demand study might be considered too low for the purposes of an assessment of the relevant product market. However, we consider that it is highly unlikely that substitution of this type would be large and in the absence of direct evidence to the contrary, we consider that the elasticity estimates from the econometric demand study are an accurate guide to the degree of substitution that would arise in the event of an increase in bus fares.

5.14 Further discussion of the results of the econometric demand study is presented in paragraphs 5.20 to 5.24 and 5.28. Appendix 5.2 contains a more detailed discussion of the comments we received on the study.

Customer survey

5.15 We commissioned a customer survey to analyse various aspects of customer demand. In particular, the customer survey provides information on two aspects of

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8 See Appendices 5.2 & 5.3.
9 Typically the short run and long run are defined in terms of the factors that customers can vary. In the short run customers can choose their method of travel or whether or not to travel, however certain factors that influence a customer’s decision (such as car ownership, location of home and location of work) are considered fixed. In the long run these factors are also considered to be variable so that, for example, passengers are able to avoid high fares by moving home.
13 Similar arguments apply to the conjoint exercise in the CC survey; however, the conjoint exercise did not model how changes in competitive variables might induce passengers to change their ticket type.
customer demand. First, it measures the impact and relative importance of different aspects of bus operators’ offerings, in addition to the importance of price, on customer demand. Second, it measures the propensity for customers to switch between different bus operators, where they face a choice, in response to small relative changes in various aspects of operators’ offerings. A detailed description of the methodology and the results of this survey are found in the published survey report.14

5.16 The customer survey contains responses from a sample of 1,100 individuals, largely composed of local bus users, but with a small sample of non-users of local bus services. The survey recruited and interviewed respondents at home about a recent trip they made, as well as asking general questions about their use of local bus services.

5.17 The survey distinguished between several different categories of respondent, to allow us to compare results across these groups:

(a) Users and non bus-users.

(b) Rural and urban areas. Non-bus users were interviewed only in urban areas.

(c) Within urban areas, the survey recruited and interviewed bus users along specific corridors, which we classified as ‘more competitive urban corridors’ and ‘less competitive urban corridors’. We defined these corridors such that bus users on more competitive corridors were likely to face a genuine choice between two or more bus operators for their trip, whereas customers on less competitive urban corridors were unlikely to face a choice between operators for their trip. More detail on how we defined these two types of corridor is contained in the survey report (page 7).

(d) Concessionary15 and non-concessionary (ie fare-paying) passengers. This was important as concessionary passengers do not pay any fares (after 9.30am in England and at all times in Scotland and Wales) and so, for example, the aspects of operators’ services that drive demand for concessionary passengers might be different from those aspects that drive demand for non-concessionary passengers.

(e) Among fare-paying passengers, we distinguished between two different categories of ticket type: (i) single, return or day tickets, and (ii) longer-duration season tickets.16

(f) Time-constrained and non-time-constrained trips for fare-paying passengers in urban areas. This allows us to explore, for example, whether fare-paying bus users on time-constrained trips are more or less likely than those on non-time-constrained trips to be sensitive to changes in fares or bus quality.

5.18 For an individual trip, the survey asked customers how they had made decisions about that trip both while planning their trip and once at the bus stop. This included the decision to travel by bus and, where relevant, the decision to use a particular bus

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15 70 per cent of concessionary users in our survey were over 65, and a further 19 per cent were over 55, and hence the large majority of concessionary passengers in our survey are likely to be part of the national concessionary fare scheme. In certain local areas, concessionary fare schemes cover other age groups (eg people with disabilities) which are likely to account for the remaining proportion of concessionary users in our survey.
16 In other areas of our analysis (for example, in relation to our analysis of network effects—see Section 8) we distinguish between single tickets and multi-journey tickets (return, day and longer-duration season tickets). In interpreting the results in our customer survey by ticket types, we recognize that the survey does not allow us to distinguish between single ticket users and users of return or day tickets.
operator. The customer survey also included a conjoint analysis which estimated the impact of the levels of each of fare, frequency, punctuality, seat availability and cleanliness on customer demand. The exercise involved presenting customers with a series of pairs of choices between operators with different levels of these characteristics. We used these results to estimate the impact of these characteristics on customer demand and the propensity for customers to switch based on small changes in these characteristics.

5.19 As with the econometric demand study, the customer survey allows us to estimate market level elasticities, which we discuss in detail in paragraphs 7.27 and 7.30. The survey also allows us to estimate firm-level elasticities which are presented in paragraphs 5.42 to 5.51. In the remainder of this section, we discuss the implications of our customer survey, as well as other sources of evidence, on key aspects of customer demand and choice. Appendix 5.3 sets out the comments we received on our survey and our responses to them.

**Why and how customers use the bus**

5.20 Our econometric demand study found that individuals aged under 15 and those aged 60 or over are more likely to use the bus than those between the ages of 15 and 59.17

5.21 The results of our customer survey show that users of multi-journey tickets of duration longer than one day were mainly travelling to and from work/place of education (73 per cent), while those travelling on single, return or day tickets were more equally divided between trips for shopping (28 per cent) or going to/from work (28 per cent). The remainder of those travelling on single, return and day tickets were split between a variety of other journey purposes. Concessionary passengers were mainly going shopping (64 per cent).

5.22 The econometric demand study collected information on the time of respondents' bus trips, which showed that the most common periods for travel are 8am, 3pm and 5pm.18 The CC customer survey also collected information on the time of travel (day of week and time of day) and found that season ticket customers mostly made trips before 10am on a weekday (which is likely to be because they were travelling to work/place of education).

5.23 The customer survey results show that the average trip length for survey participants was 14 to 19 minutes. The average wait time for trips was 7 minutes.

5.24 The econometric demand study found that individuals living in larger settlements are more likely to travel by bus.19 Our customer survey allows us to explore the reasons why individuals use the bus across the three types of corridor in our sample. 22 per cent of all users on more competitive urban corridors and 25 per cent of all users on less competitive urban corridors stated that the bus was the only form of transport available to them. This was the case for a more substantial proportion of rural bus users (46 per cent). Consistent with this, the econometric demand study found that individuals without access to a car are between four and six times more likely to travel by bus than individuals with access to a car.20

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17 *A Disaggregate Analysis of Demand for Local Bus Service in Great Britain (excluding London) using the National Travel Survey*, L Nesheim and J Molnar, 2010, Table D6.
18 *Ibid*, Table D1.
19 *Op cit*, Table D8.
20 *Op cit*, Table D2.
Our customer survey asked all bus users the main reason why they chose to travel by bus. Bus users on urban corridors said that they chose the bus over other transport options because it was cheaper than other methods of travel. These results are presented in Table 5.1.

### TABLE 5.1 Reasons for choosing the bus

<table>
<thead>
<tr>
<th></th>
<th>Urban</th>
<th>Rural</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>More competitive %</td>
<td>Less competitive %</td>
</tr>
<tr>
<td>Cheaper (any mention)</td>
<td>39</td>
<td>42</td>
</tr>
<tr>
<td>Only form of transport available</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>(Stops) closer to home/destination</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>Quicker (than other modes)</td>
<td>13</td>
<td>21***(rural)</td>
</tr>
<tr>
<td>Less hassle/more relaxed</td>
<td>10</td>
<td>15***(rural)</td>
</tr>
</tbody>
</table>

Source: CC survey report, Figure 7.i.

**Base:** All Users. Competitive (397), Not competitive (443), Rural (148).

**Note:** Levels of significance * 90%, ** 95%, *** 99% eg *(rural) means we are 90 per cent sure that the figure is significantly different from the figure for rural areas.

**Aspects of local bus operators’ offerings that influence bus choice**

**CC survey**

The results of the conjoint analysis in our customer survey (see paragraph 5.18) allow us to estimate the impact of different characteristics of local bus services on customer demand, and are shown in Figure 5.1. To examine the impact of a step change in a particular variable, the other variables were held constant (ie fares and frequencies were held constant at the current fare and frequency, reliability was held constant at buses being ‘always on time’, seat availability was held constant at ‘plenty of seats’ and bus cleanliness was held constant at ‘clean’).
FIGURE 5.1

Impact of attribute levels on bus choice

5.27 Figure 5.1 shows the way in which the volume of trips on the bus changes as the levels move from the worst case on each variable to the best case. For each variable, the ‘worst case’ has been set at 0. The results show that no one characteristic appears to dominate choice.

Econometric demand analysis

5.28 The econometric demand study analysed how demand for bus travel varied according to certain characteristics of the local bus network. This provides some indirect evidence on how these factors might influence bus choice and demand. The econometric demand study confirmed that individuals are more likely to travel by bus if they live near a bus stop and if their local bus service is relatively frequent. More than 90 per cent of demand for bus trips is from individuals that live within 6 minutes’ walk of a bus stop.21

Other information

5.29 We asked the Large, the Mid-Sized and the Tier 1 Small Operators22 which aspects of their bus service their customers value (see Appendix 5.1, paragraphs 1 to 8). Most operators told us that the most important factors for their customers were reliability/punctuality, followed by frequency and value for money.

Source: CC customer survey report, Figure 12.iii.

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22 For some pieces of analysis we have distinguished between two categories of Small Operators. Tier 1 Small Operators are those that are at least the second largest operator in at least one urban area with a share of supply of at least 25 per cent, according to our analysis of the Traveline database.
5.30 The DfT conducted research\textsuperscript{23} intended to provide a better understanding of the importance of what it termed ‘qualitative “softer” factors’\textsuperscript{24} in determining bus patronage trends. In particular, this research was focused on understanding what made customers switch to the local bus from cars (modal shift). Qualitative evidence from this research suggested that soft factors could enhance the bus journey experience, but only when certain hard factors, particularly frequency and reliability, have reached acceptable thresholds. Quantitative evidence found that the highest-value soft measures were CCTV at bus stops and on-bus and driver quality, reflecting a concern for safety and security. This evidence is discussed in more detail in Appendix 5.1, paragraphs 9 to 11.

5.31 Passenger Focus conducted research to assess passengers’ priorities for improvements to the bus services. This found that punctuality was the number one priority for improvement, followed by increased frequency, the ability to get a seat, greater availability of multi-operator tickets, and buses going to a wider range of destinations.\textsuperscript{25} This evidence is discussed in more detail in Appendix 5.1, paragraph 12.

**Customer switching between bus operators**

5.32 In our discussion of customer switching, we begin by exploring whether customers tend to board the first bus that arrives at the stop. This is important because if customers tend to board the first bus that arrives, this will suggest that switching between operators is largely driven by arrival times rather than other aspects of operators’ services. We then consider the extent to which customers switch between operators in response to relative changes in various aspects of bus operators’ offerings.

**Passenger choices in planning their trip and at the bus stop**

5.33 Understanding the behaviour of passengers once at the bus stop is important in considering how bus companies compete, and we discuss this in detail in Section 8. Arriva, Go-Ahead and National Express told us that one important feature of the local bus service industry was that customers often boarded the first available bus that was headed towards their destination. FirstGroup told us that customers generally got on the first bus that they saw, but that customers also planned their choice in advance, trading off other aspects of operators’ offerings, including price and quality aspects.

5.34 In this section, we explore, using our customer survey, the various decisions bus passengers make in the course of a journey. We present results from only those survey respondents who made bus trips on more competitive urban corridors as there was a choice of bus operator on these corridors. We find that a substantial proportion of customers plan the bus they are going to use in advance, according to timetable, or fares, or the nature and quality of service. However, for customers who are not already committed to a particular operator by having already bought a ticket, these attributes are largely overridden by a bus being first to arrive at the bus stop.

\textsuperscript{23} The Role of Soft Measures in Influencing Patronage Growth and Modal Split in the Bus Market in England, DfT, October 2009.

\textsuperscript{24} Those centring on informing individuals or segments of society about available public transport services and providing a more desirable travel experience, whereas hard measures could be defined as physical engineering measures, impacting on journey time or reliability and changes to the operation of services in terms of frequency or coverage. The research included both of these categories of factors.

\textsuperscript{25} Passenger Focus, ‘Bus passenger priorities for improvement, March 2010’, p11.
5.35 Our survey asked bus users about their choice of operator at the planning stage of a trip and once they were at the bus stop. At the planning stage of their trip, 45 per cent of all bus users on more competitive urban corridors considered more than one bus operator for their trip. Once at the bus stop this percentage dropped to 16 per cent. We present results separately for concessionary, single/return/day ticket holders and longer-duration season ticket holders in Table 5.2.

<table>
<thead>
<tr>
<th>TABLE 5.2</th>
<th>Proportion of customers on more competitive urban corridors that considered another operator per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fare-paying Single/return/day tickets</td>
</tr>
<tr>
<td>At the planning stage of the trip</td>
<td>43*(season)</td>
</tr>
<tr>
<td>At the bus stop</td>
<td>20**(concessionary)</td>
</tr>
</tbody>
</table>

Source: CC customer survey.

Note: Levels of significance * 90%, ** 95%, eg *(season) means we are 90 per cent sure that the figure is significantly different from the figure for season ticket holders.

5.36 For the passengers in Table 5.2 that considered another operator, we analyse in more detail the choices they made between operators, and whether they boarded the first bus that arrived (see paragraphs 5.37 to 5.39 and Table 5.3).

5.37 Those bus users who had considered other bus operators at the planning stage of their trip were asked why they had planned to use a particular operator over others. Bus users listed a variety of reasons for choosing an operator, with no one reason accounting for more than 20 per cent of responses. In our conjoint analysis (see paragraphs 5.26 and 5.27) we also found that customers switch between operators in response to a variety of aspects of an operator’s offering at the planning stage of a trip. These results show that bus users plan to catch a specific bus based on a variety of aspects of an operator’s offering.

5.38 We asked those bus users who had considered another operator once they were at the bus stop (ie those in Table 5.2) why they chose it. The most common reason was because it arrived first (54 per cent), and no other reason was cited by more than 10 per cent of these bus users. We present these figures separately for concessionary, single/return/day ticket holders and longer-duration season ticket holders in Table 5.3. This shows that 57 per cent of single/return/day ticket holders chose the operator they used because it was the first to arrive. This proportion falls to 17 per cent for longer-duration season ticket holders. Our qualitative survey also found that people tended to get on the next available bus unless they were aware that another bus was going to arrive very soon.

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26 114 bus users on more competitive urban corridors considered more than one company at the planning stage of the trip; 60 bus users on more competitive corridors considered other companies at the bus stop.

27 We could not analyse further the choices made in practice by bus users that said that they did not consider another operator.

28 Reasons included, in descending order of how often the reason was cited: it was likely to be the first to arrive; regular/frequent service; only choice/only one; did not plan; time of arrival was most suitable; went to the required destination; convenient/handy; reliable; cheaper; cleaner; quicker; stops at a bus stop closer to home; punctual; more comfortable; used it before; most direct. Other reasons were cited by less than 1 per cent of all bus users.

29 For some of these customers this may have also been the bus they had originally planned to take.
TABLE 5.3 Proportion of passengers on competitive corridors who chose a particular operator because it was the first to arrive at the bus stop

<table>
<thead>
<tr>
<th></th>
<th>Fare-paying</th>
<th>Concessionary</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Single/return/day tickets</td>
<td>longer duration season tickets</td>
</tr>
<tr>
<td>At the planning stage of the trip</td>
<td>34*(concessionary)</td>
<td>18</td>
</tr>
<tr>
<td>At the bus stop</td>
<td>57**(season)</td>
<td>17</td>
</tr>
</tbody>
</table>

Source: CC customer survey.

Base: Bus users that considered another operator at either the planning stage or once at the bus stop, on competitive corridors.

Note: Levels of significance * 90%, ** 95%, *** 99%, eg **(season) means we are 95% sure that the figure is different from the figure for season ticket holders.

5.39 The results presented in Table 5.3 show that for the majority of single/return/day ticket customers, the aspects of service that may have induced them to choose a particular operator at the planning stage of a trip (outlined in paragraph 5.37) are overridden by a bus being first to arrive. This result is most likely driven by single-ticket customers since these tickets do not involve any pre-commitment to a specific operator (although as noted in paragraph 5.17(e), we are unable to test this).

5.40 70 per cent of all bus users on more competitive urban corridors gave the name of the operator they were planning to use and the name of the operator they actually used. Only 2 per cent of these customers switched operator at the bus stop because a bus run by another operator arrived first at the bus stop. Although we could not analyze the reasons why customers did not switch, the low level of switching provides further evidence that customers are likely to plan in advance which operator they wish to use and arrive in time for that service.

5.41 Overall, therefore, we find that a substantial proportion of customers plan the bus they are going to use in advance. This is consistent with evidence from the operators that customers value a variety of aspects of their offer (see paragraph 5.29 above) and that customers switch between operators at the planning stage of the trip based on a number of attributes of operators’ offerings (see paragraphs 5.26, 5.27 and 5.37 above). However, for single/return/day ticket customers, once at the bus stop these attributes are largely overridden by a bus being first to arrive: 57 per cent of these ticket holders for which we have information chose the operator that they used because it was first to arrive. This is consistent with evidence from Arriva, FirstGroup, Go-Ahead and National Express outlined in paragraph 5.33, and is consistent with customers wishing to minimize the cost of waiting.

Customer switching in response to relative changes in operators’ offerings

5.42 In this section, we explore customers’ propensity to switch between local bus operators at the planning stage of a trip on the basis of relative changes in their offerings. This willingness will be one factor in determining customers’ decisions about which bus to plan to arrive for at the bus stop, but as we find in paragraphs 5.34 and 5.41 above, for single/return/day ticket customers this switching will often be overridden once at the bus stop by customers’ propensity to board the first bus that arrives.

5.43 As set out in paragraph 5.18, our customer survey included a stated preference conjoint exercise. When framing this exercise, we asked customers to think about the choice between operators at the planning stage of a trip, rather than at the bus stop, and hence the results on customer willingness to switch are most relevant to willingness to switch at the planning stage of a trip. Again, we report conjoint results from
more competitive urban corridors only, as these customers are likely to have experienced a choice between operators for a recent trip.

5.44 This analysis found that on more competitive urban corridors passengers would respond to a change in an operator’s fares. Table 5.4 shows that following a 25 per cent increase in an operator’s fares, there would be a fall of just over 40 per cent in the number of trips made by fare paying bus users with that operator. This corresponds to an own-price elasticity of demand of -1.7.31

5.45 Table 5.4 also shows that the large majority of customers who switch away from a bus operator following an increase in its prices switch to another bus operator, rather than switching to alternative transport modes or choosing not to make the trip at all. Following a 25 per cent increase in a bus operator’s fares, around 40 per cent of fare paying bus users on more competitive urban corridors would switch to another operator. This corresponds to a cross-price elasticity of 1.6. Similarly, if an operator reduces its price, the large majority of the increase it sees in its passenger numbers is due to passengers switching away from other bus operators in response to the relative price change. The survey indicated that both users with different ticket types, and those that were time-constrained and non-time-constrained users, showed a similar propensity to switch between bus operators following a price change.

### TABLE 5.4 Changes in passenger volumes in response to a 25 per cent change in operator A’s fares

<table>
<thead>
<tr>
<th>% change in original operator A’s passenger numbers</th>
<th>Urban user—competitive</th>
<th>25% increase in Operator A’s prices</th>
<th>25% decrease in Operator A’s prices</th>
<th>25% increase in Operator A’s prices</th>
<th>25% decrease in Operator A’s prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>% that switch to:</td>
<td></td>
<td>Total</td>
<td>Time-constrained</td>
<td>Total</td>
<td>Time-constrained</td>
</tr>
<tr>
<td>Operator B</td>
<td></td>
<td>40.7</td>
<td>40.8</td>
<td>41.2</td>
<td>49.0</td>
</tr>
<tr>
<td>Alternative mode</td>
<td></td>
<td>1.0</td>
<td>37.9</td>
<td>37.0</td>
<td>47.5</td>
</tr>
<tr>
<td>Not travel</td>
<td></td>
<td>0.0</td>
<td>2.7</td>
<td>4.1</td>
<td>1.3</td>
</tr>
<tr>
<td>Sample size</td>
<td></td>
<td>68</td>
<td>102</td>
<td>115</td>
<td>68</td>
</tr>
</tbody>
</table>

Source: CC customer survey.

5.46 In paragraphs 7.31 and 7.32, we find that the market-level own-price elasticity of demand for bus travel is low and that changes in the fare or service offered by local bus operators have little effect on passengers’ choice of travel mode. This evidence, combined with the evidence in paragraphs 5.44 and 5.45 above on own- and cross-price elasticities, suggests that there are substantial ‘business-stealing effects’ in local bus services, with respect to prices. In other words, if a bus operator reduces its prices on a route where it faces competition from another operator, it can expect to achieve increases in its revenue, but this will largely be as a result of customers switching from other bus operators, rather than as a result of this operator growing the overall demand for bus services.

5.47 Our customer survey found that on more competitive urban corridors, if an operator’s frequency was halved, its number of fare-paying passengers would fall by 36.4 to 37.9 per cent. This corresponds to an own-elasticity with respect to frequency of 0.7

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30 The 25 per cent fare change was suggested by our qualitative research as a change in fares that was recognized and responded to by bus users. See p10: www.competition-commission.org.uk/inquiries/ref2010/localbus/pdf/survey_final_report_221210_for_publication.pdf.

31 We define an operator’s own-price elasticity as the percentage change in its volume following a percentage change in its price, holding all other operators’ prices, and the price of other methods of travel, fixed.
to 0.8. The own-elasticity with respect to frequency for concessionary passengers is higher (1.1).

5.48 As with prices, we can also analyse cross-elasticities with respect to frequency using our customer survey. Our customer survey found that, where customers faced a choice of operators, if one operator’s frequency was halved, just over one-third of fare-paying customers would switch to another bus operator, as shown in Table 5.5. This corresponds to a cross-elasticity with respect to frequency of –0.7. Concessionary passengers are more likely to switch to another operator (52 per cent would switch if an operator’s frequency was halved, corresponding to a cross-elasticity with respect to frequency of 1.0).

**TABLE 5.5** Changes in passenger volumes in response to a doubling/halving of Operator A’s frequency

<table>
<thead>
<tr>
<th>% change in original operator A’s passenger numbers</th>
<th>Season</th>
<th>Single, Return, Day ticket</th>
<th>Concessions</th>
<th>Season</th>
<th>Single, Return, Day ticket</th>
<th>Concessions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Op A’s passenger numbers</td>
<td>Total</td>
<td>Time-constrained</td>
<td>Not time-constrained</td>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>Change in Op A’s passenger numbers</td>
<td>–36.4</td>
<td>–37.9</td>
<td>–37.6</td>
<td>–53.7***</td>
<td>(fare-paying)</td>
<td>38.3</td>
</tr>
<tr>
<td>% that switch to:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operator B</td>
<td>34.8</td>
<td>35.0</td>
<td>33.1</td>
<td>52.0</td>
<td>–36.0</td>
<td>–37.3</td>
</tr>
<tr>
<td>Alternative mode</td>
<td>1.6</td>
<td>2.9</td>
<td>4.5</td>
<td>1.0</td>
<td>–2.1</td>
<td>–5.4</td>
</tr>
<tr>
<td>Not travel</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.6</td>
<td>–0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Sample size</td>
<td>68</td>
<td>102</td>
<td>115</td>
<td>77</td>
<td>68</td>
<td>102</td>
</tr>
</tbody>
</table>

Source: CC customer survey.

5.49 This elasticity with respect to frequency holds punctuality fixed—eg customers know that even if a service is relatively infrequent, they can be sure about how punctual the bus they plan to catch will be. In reality, punctuality and actual frequency might be linked. For instance, customers might be more willing to catch an infrequent service if they are sure that it will be punctual, while if they are unsure about punctuality, a customer might prefer a more frequent service. The CC’s customer survey does not contain any information on this, or how it might influence elasticity with respect to frequency. However, paragraphs 5.26 to 5.31 discuss the importance of factors other than prices and frequencies in determining choice of bus operator/mode of transport, and find that a variety of sources suggest that punctuality and reliability are important aspects of service quality.

5.50 As with prices, the evidence on own- and cross-elasticities with respect to frequency suggests that there are substantial ‘business-stealing’ effects in local bus services in relation to frequency. In other words, if an operator increases its frequency, the increase in demand for its services will largely be as a result of customers switching from other operators, rather than as a result of an increase in the overall demand for bus services.

5.51 As noted in paragraph 5.42, the results presented in paragraphs 5.44 to 5.50 are likely to relate to the planning stage of a trip, and as a result it appears that customers will plan to use operators based on a variety of aspects of their offerings, and would also switch between operators at this stage, in particular in response to relative price differences. As set out in paragraph 5.34, for customers who are not already committed to a particular operator by having already bought a ticket, these attributes are largely overridden by a bus being first to arrive at the bus stop.
Customers’ usage of the bus network

5.52 In this section, we assess to what extent customers make return journeys, and to what extent customers use more than one route in a local bus network. This evidence is derived from two sources: (i) the ticket types that customers buy, and (ii) direct evidence on the customers’ usage of the local bus network. We analyse each category of evidence in turn.

What type of tickets do customers buy?

5.53 In this section, we look at what tickets customers buy as this is informative about the trips they make across the local bus network.32 We consider: the proportion of passengers purchasing different ticket types; the proportion of trips accounted for by customers with different ticket types; and the proportion of revenue accounted for by sales of different ticket types. We consider that figures on proportions of different ticket types sold (which are set out in Appendix 5.1, Tables 8 and 9) are less informative about the relative use made of them by customers. Single tickets might be purchased more than once by an individual, during the course of a day or a week, for example; in which case, the proportion of ticket sales accounted for by single tickets is likely to be higher than the proportion of ticket sales accounted for by return or season tickets for the equivalent number of trips. Comparing the proportion of passengers that purchase different ticket types or the proportion of journeys made using different ticket types therefore gives more information about individual passenger behaviour.

5.54 Multi-journey tickets include return, day, weekly, and longer duration tickets. These are more expensive than single tickets but in general offer a lower cost per trip if passengers make (at least) two trips per day (or in the case of weekly tickets, at least ten trips per week).33 This suggests that customers purchasing tickets other than single tickets (usually) make at least two trips per day. For return ticket customers, this will be a return journey on an individual route. Day, weekly and longer duration tickets, which are sometimes referred to as season tickets might however be valid on just one route or might be valid across a network (in which case they might be referred to as network tickets). Consequently, we cannot determine whether a customer that purchases a day, weekly or longer-duration multi-journey ticket, makes a return journey on an individual route or uses more routes on a network. This was emphasized by Stagecoach, who told us that it had concerns regarding treating day tickets as a separate category of ticket from return tickets, as in some areas return tickets will not be offered and day tickets will be used in place of returns. The proportion of passengers using day tickets (or the proportion of revenue from these tickets) provides evidence for the proportion of passengers using (or revenue from) tickets purchased for at least two journeys per day—we do not infer from these proportions whether these tickets are used for one return journey on an individual route or across

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32 Evidence from operators and evidence from NTS and Passenger Focus surveys do not make the distinction between more and less competitive urban corridors, as we make with our survey.

33 The following examples illustrate the saving customers can make using multi-journey tickets rather than repeat purchases of single tickets (and the multi-journey tickets also give access to further journeys and use of the rest of the network): a FirstGroup return ticket for travel within Glasgow costs either £3 or £3.45 (depending on the number of zones travelled), which is cheaper than the price of two single fares (£1.80 each for more than five stops); a National Express weekly ticket (covering Birmingham, Coventry and the Black Country) costs £14.50, which is cheaper than buying two single tickets five days a week (single tickets cost £1.80 each); making two trips per day five days a week for four weeks using NCT single tickets would cost £64 (single tickets are £1.60), whereas a monthly network ticket (Adult EasyRider City Card) costs up to £52.75 depending on the method of purchase. (source: operators’ websites, April 2011).
more than one bus route in a network. In paragraphs 5.63 to 5.77, we present more direct evidence on the use passengers make of routes in a network.

Passenger Focus

5.55 Passenger Focus conducts a large-scale survey of bus users in England (outside London), which contains information on the ticket types customers purchased. The survey contains information from 20 English administrative areas, including the six PTEs, in which well over half of all bus journeys in England outside London are made. The summary information is presented in Table 5.6. In Appendix 5.1, we present the figures from each area individually (Table 10), as well as figures for peak versus off-peak journeys (Table 11), and for different trip types (Table 12).

<table>
<thead>
<tr>
<th>TABLE 5.6 Number of customers travelling with different ticket types</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash single</td>
</tr>
<tr>
<td>-------------</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

Source: Passenger Focus.

Note: Bus-only day ticket and bus-only ticket for more than one day include multi-operator bus-only tickets.

5.56 The most common ticket type purchased is a ‘bus-only ticket valid for more than one day’ (ie weekly or longer-duration multi-journey tickets), accounting for 29 per cent of fare-paying users. 53 per cent of fare-paying passengers use multi-journey tickets (and 33 per cent of all passengers, ie including concessions). As explained in paragraph 5.54, we can infer that these customers are making at least two journeys per day (a return trip in the case of return ticket holders). These figures include any customers that use multi-operator bus-only tickets valid for more than one day. As for the NTS data and the CC’s customer survey we cannot separate multi-operator from single-operator tickets for this data. However, in Section 9 and Appendix 9.5, we show that the evidence suggests that the take-up of multi-operator tickets is currently limited.

5.57 The total figures mask a significant amount of variation across local areas. In Greater Manchester, Dorset, Bristol, Lincolnshire, Southampton, Tyne and Wear and the West Midlands, for example, there are more than the average number of passengers travelling on bus passes valid for more than a day, while in Cornwall, Cumbria, Medway Kent, Merseyside, Shropshire, Stoke-on-Trent, South Yorkshire and West Yorkshire there are more than the average number of passengers travelling on single tickets. We did not identify any pattern of season and return ticket versus single ticket usage according to types of area (for example, rural counties versus PTE areas).

34 There may be exceptions in certain local areas, where we can infer more about passenger behaviour from observing that a passenger purchased a day, weekly or longer-duration season ticket. For example, where a day ticket is priced higher than the cost of two single tickets (or more than the cost of a return ticket), we can reasonably infer that day ticket users are conducting more than one return journey on an individual route (either a repeated return journey on one route or journeys across more than one route in a network). We do not, however, have detailed evidence on local prices in all areas that allow us to identify all such exceptions.

35 This includes any customers that use multi-operator bus-only tickets valid for more than one day.
We use the NTS to analyse the average proportions of different ticket types used across the reference area. Within the NTS, we identified those journeys where the bus was the main method of transport used, and then looked at the ticket types used to make those journeys. This information is presented in Table 5.7. We note that ticket type was self-reported and therefore open to interpretation. We also note that these figures represent averages and figures for individual routes or areas are likely to vary. Finally, we note that the definition of ticket types in the NTS is different from that contained in our survey (see paragraph 5.17(e) above).

<table>
<thead>
<tr>
<th>% of all GB bus trips excluding London</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adult single/return*</td>
</tr>
<tr>
<td>Adult day ticket†</td>
</tr>
<tr>
<td>Season ticket/travelcard</td>
</tr>
<tr>
<td>Concessions</td>
</tr>
<tr>
<td>All other tickets</td>
</tr>
</tbody>
</table>


*Adult single/return tickets are termed ‘Ordinary adult’ in the survey.
†Adult day tickets are termed ‘Adult one-day travelcard’ in the survey.

These figures show that 17 per cent of all passenger trips are conducted using day or longer-duration multi-journey tickets. After excluding concessions, 29 per cent of fare-paying trips are conducted using day or longer-duration multi-journey tickets. This does not include return tickets. Return tickets, however, cannot be separated from single tickets in the NTS.

Data from local bus operators

We collected data from six operators (as listed in Table 5.8) on the revenue they derive from sales of different ticket types. Table 5.8 shows the proportion of on-bus and off-bus revenue and total revenue (on-bus and off-bus revenue excludes concessionary and tendered service revenue, which is included in the total revenue figure) across all of these six operators’ routes accounted for by tickets other than single (and, as also shown in the table, return) tickets, and shows that a substantial proportion of revenue is accounted for by season tickets, which are likely to be used to make at least two journeys per day. In particular, the unweighted average proportion of these operators’ on- and off-bus revenue accounted for by multi-journey tickets, which are likely to have been used for at least two journeys per day, is 62.9 per cent. The unweighted average proportion of on- and off-bus revenue accounted for by season tickets (i.e. not singles or returns) is 51.8 per cent, and two operators obtained a majority of their on- and off-bus revenue from these tickets.

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36 We note that the proportion using a day ticket may be an underestimate if some respondents have interpreted ‘ordinary adult’ as including day tickets. Similarly, some users of day tickets may have classified these as a travel card which would also lead to an underestimate of the proportion using a day ticket.
37 Stagecoach told us that the average figures for its operating companies were different from the figures in this table.
38 On-bus revenue is revenue that is collected from transactions upon boarding the bus. Off-bus revenue (excluding tendered service and concessionary revenue) is revenue from ticket sales on channels other than on-bus transactions (such as in travel centres, stations, etc).
TABLE 5.8: Proportion of operators’ revenue (excluding concessionary and tendered services revenue) accounted for by different ticket types

<table>
<thead>
<tr>
<th>Year</th>
<th>On-bus revenue</th>
<th>On- and off-bus revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Tickets other than singles and returns</td>
<td>Tickets other than singles</td>
</tr>
<tr>
<td>Arriva</td>
<td>2009</td>
<td>[X]</td>
</tr>
<tr>
<td>FirstGroup</td>
<td>2009</td>
<td>[X]</td>
</tr>
<tr>
<td>Go-Ahead</td>
<td>2009</td>
<td>[X]</td>
</tr>
<tr>
<td>National Express</td>
<td>2009</td>
<td>[X]</td>
</tr>
<tr>
<td>Stagecoach</td>
<td>2009</td>
<td>[X]</td>
</tr>
<tr>
<td>Unweighted average</td>
<td>2009</td>
<td>39.9</td>
</tr>
</tbody>
</table>

Notes: CC analysis of operators’ data.

Notes:
1. National Express [X].
2. Arriva has performed equivalent calculations on equivalent data and its figures are within 1 per cent of those presented in this table.
3. Stagecoach produced its own equivalent analysis of the same data, which produced near identical results.
4. [X].

5.61 Stagecoach told us that the figures in Table 5.8 overstate the importance of multi-journey ticket revenue to an operator, as operators will also derive revenue from concessionary fares reimbursement and tendered services payments from local authorities. Stagecoach told us that season tickets account for [X] per cent of its total revenue. We recognize that multi-journey tickets will account for a lower proportion of total revenue than the proportions presented in Table 5.8. However, in this section we are seeking to understand customer behaviour. As such, the proportion of on- and off-bus revenue (ie not including tendered and concessionary revenue) accounted for by non-single and return tickets gives a better indication of the propensity of passengers to purchase multi-journey tickets, compared with single tickets.

5.62 We sought evidence on the take-up of different ticket types by customers. The range of evidence is presented in Appendix 5.1, paragraphs 11 to 17. We found that the proportion of journeys carried out using single tickets varied considerably between areas, from 14 per cent [X] to 69 per cent [X]. In most areas, less than half of journeys were made using a single ticket.

Do customers use a network of routes?

5.63 As noted in paragraphs 5.54 and 5.56, in general we can infer from data on ticket types sold the proportion of customers that make at least two journeys per day (along one route in the case of return ticket customers), but are unable to use this data to determine whether customers of day, weekly or longer-duration season tickets use more than an individual route in a network. In this section, we present more direct evidence on whether customers use more than one route in a network.

The CC’s customer survey

5.64 The CC’s customer survey asked users whether they had to catch more than one bus to reach their destination (see paragraphs 5.15 to 5.19 for an overview of our survey methodology). We found that out of all bus users, 12 per cent had to catch more than one bus to reach their destination. This overall percentage masks variation by type of user and ticket type: 23 per cent of weekly or longer-duration season ticket

5-16
users; 13 per cent of single, return or day ticket users; and 7 per cent of concessionary users had to catch more than one bus to reach their destination.\footnote{The proportion of season ticket customers that had to catch more than one bus to reach their destination is statistically significantly different from the proportion of single/return/day ticket holders and concessionary users at the 1 per cent level. The proportion of single/return/day ticket holders that had to catch more than one bus to reach their destination is statistically significantly different from the proportion of concessionary users at the 5 per cent level.} Within the 13 per cent of single/return/day ticket users who catch more than one bus to reach their destination, we cannot distinguish between single, return and day tickets (see paragraph 5.17(e)).\footnote{FirstGroup told us that the proportion of customers of single/return/day tickets that make interconnecting journeys, and the proportion of all interconnecting journeys that are made using single/return/day tickets illustrates that customers are readily able to switch between network and single tickets to make journeys involving more than one route. Stagecoach told us that customers using a second route only once a week, for example, might purchase a route specific multi-journey ticket for their main route and a single fare for the route used only once a week, and that this could be cheaper because route-specific multi-journey tickets were priced lower than multi-journey tickets valid on several routes (Stagecoach response to provisional findings, paragraph 4.28). As we explain above, we are unable to determine whether these customers are using single, return or day tickets.}

Customers might use more than one bus route in a network, even if this does not involve using more than one bus route in the course of an individual journey. For example, a weekly ticket customer might make journeys on different routes over the course of a week. The CC’s customer survey allows us to look at how many different passengers use more than one route across a network. 53 per cent of fare-paying users in the CC’s customer survey used two or more different routes ‘on a regular basis’. The proportion of users of multi-journey tickets of longer duration than a day who use two or more routes on a regular basis is higher than the proportion of single/return/day pass customers using two or more routes in a week (58 per cent compared with 47 per cent).\footnote{We cannot tell from the survey results what customers meant by ‘regular’ when they responded to this question. For example, a smaller proportion than this 53 per cent appear to use more than one route in the course of a day, as the majority of day tickets appear to be used as return tickets—see paragraph 5.67.}

Customers might use more than one bus route in a network, even if this does not involve using more than one bus route in the course of an individual journey. For example, a weekly ticket customer might make journeys on different routes over the course of a week. The CC’s customer survey allows us to look at how many different passengers use more than one route across a network. 53 per cent of fare-paying users in the CC’s customer survey used two or more different routes ‘on a regular basis’. The proportion of users of multi-journey tickets of longer duration than a day who use two or more routes on a regular basis is higher than the proportion of single/return/day pass customers using two or more routes in a week (58 per cent compared with 47 per cent).\footnote{This difference is statistically significant at the 5 per cent level.}

We can also use the CC’s customer survey to analyse how many days of the week customers use local bus services, although we cannot use these figures to analyse the number of journeys in a day. We cannot use the information on how many days of the week customers use local bus services to assess how many different bus routes customers use ‘on a regular basis’. Nevertheless, the CC’s customer survey shows that 62 per cent of weekly and longer-duration season ticket users use the bus more than five days a week.

\textit{NTS}

The NTS data allows us to look at the number of bus boardings bus users make to complete a given journey—ie we can look at whether customers on average make interconnecting bus trips to complete a given journey. 10 per cent of all journeys\footnote{This is all journeys 2002–2008. The proportion is similar in each year.} were interconnecting, and hence involved more than one bus route. 18 per cent of all journeys where a season ticket was used were interconnecting. As set out in paragraph 5.65, customers might use a network of routes in an area not just to make interconnecting journeys, but also if customers with weekly or longer-duration season tickets use more than one bus route over the course of their season ticket’s duration.

The NTS also allows us to analyse the number of bus trips conducted on each season ticket, which provides information about the use customers make of the network of bus routes. For example, if a day ticket is used twice on average, we assume that it is most likely that these tickets are being used to make return trips on an individual route, but that these tickets are less likely to be used on more than one route in the network. Where a day ticket is used to make more than two journeys per
day, we are unable to determine whether this ticket is used to make repeat return journeys or on more than one route in a network. Figure 5.2 shows the distribution of bus trips made per day by individuals with season tickets, and shows that the large majority of season ticket users use their ticket to make two journeys a day (ie most likely a return trip).

**FIGURE 5.2**

*Bus trips per day by season ticket holders*

![Bus trips per day by season ticket holders](image)

*Source: CC analysis of The National Travel Survey, 2002–2008.*

5.69 We note that using the NTS data to measure the journeys per day by season ticket holders is likely to under-represent the number of journeys being conducted per season ticket. Season tickets often do not require photographic ID and can therefore be used by more than one member of a household, but the NTS measures journeys at an individual level so will not pick up when the same season ticket is used by more than one individual. We do not have any evidence to allow us to measure how common it is for season tickets to be used by more than one member of a household, and Stagecoach told us that it did not record whether different individuals used the same ticket and so had no data on this factor. The information presented in Figure 5.2 can therefore be seen as a lower bound on the number of journeys conducted on each season ticket.

5.70 An alternative way to measure usage of the network of bus routes is to look at journey purposes. If passengers use the bus for more than one purpose (for example, commuting to work and going to the shops), they may use more than one bus route. In the NTS data, 44 per cent of bus users used the bus for more than one journey purpose in a week (17 per cent of bus users used the bus for more than two journey purposes in a week). These percentages represent an upper bound on the number of bus users travelling on more than one bus route in a week, since the

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44 CC analysis of the National Travel Survey, 2002–2008.
destinations for some different journey purposes may be the same. Fewer bus users use the bus for more than one purpose in a day (11 per cent).

5.71 The extent to which different journey purposes correspond to travel on different bus routes in an area is likely to depend on the geography of the area. For example, in a small town where all major work, shopping and other facilities are located in a single centre, several different journey purposes are likely to involve using the same bus route. In larger or more complex conurbations, on the other hand, different attractions may be located in different parts of the conurbation and hence different journey purposes are more likely to require different bus routes. TfGM told us that in large urban areas, passengers were likely to want to travel along a number of routes. Table 5.9 also shows that there is variation in ticket usage across operating companies. The NTS does not allow us to measure directly the number of different bus routes an individual uses during the course of a week (or month).

Evidence from local bus operators

5.72 FirstGroup, National Express and Go-Ahead provided information on the average number of journeys made per ticket type in some areas, which is summarized in Table 5.9. We are not able to calculate the proportion of all services accounted for by these areas, but note that they include the services in at least three PTE areas. For the six operating areas where we have information on day ticket usage, day tickets were used on average between 2.4 and 3.7 times, and for three operating areas, day tickets were used more than three times on average. For the five operating company areas where we have information on weekly ticket usage, weekly tickets were used on average between 11.5 and 16 times in all areas, and in three areas weekly tickets were used more than 14 times on average. In addition, Stagecoach told us that in its view, based on its experience of the overall UK market, fewer than 10 per cent of passengers took more than one bus journey to reach their destination.

### TABLE 5.9 Average journeys per ticket type

<table>
<thead>
<tr>
<th>Operator</th>
<th>Day ticket</th>
<th>Weekly ticket</th>
<th>Monthly ticket</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Aberdeen</td>
<td>[x]</td>
<td>[x]</td>
<td>[x]</td>
</tr>
<tr>
<td>First West and North Yorkshire</td>
<td>[x]</td>
<td>[x]</td>
<td>[x]</td>
</tr>
<tr>
<td>First Manchester</td>
<td>[x]</td>
<td>[x]</td>
<td>[x]</td>
</tr>
<tr>
<td>National Express West Midlands</td>
<td>[x]</td>
<td>[x]</td>
<td>[x]</td>
</tr>
<tr>
<td>National Express Dundee†</td>
<td>[x]</td>
<td>[x]*</td>
<td>[x]</td>
</tr>
<tr>
<td>Go North East‡</td>
<td>[x]</td>
<td>[x]</td>
<td>[x]</td>
</tr>
<tr>
<td>Reading Transport</td>
<td>[x]</td>
<td>[x]§</td>
<td>[x]</td>
</tr>
<tr>
<td>Nottingham City Transport</td>
<td>[x]</td>
<td>[x]</td>
<td>[x]</td>
</tr>
</tbody>
</table>

*Source: National Express, Go-Ahead, Reading Transport and FirstGroup.

*National Express [x].
†Figures for National Express Dundee relate to March to May 2010 and include only adult tickets.
‡Go North East’s figures refer to its Buzzfare tickets.
§Reading Transport told us that its network ticket—which is offered for a period of a week, a month and three months—was used on average [x] times per week.

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45 Arriva told us, for example, that it considered that the same route was more likely to be used for more than one journey purpose.
46 CC analysis of the National Travel Survey, 2002–2008. This is not strictly a percentage of individuals, but a percentage of individual-day observations—so it could be a smaller proportion of individuals making more than one trip every day, or a larger proportion of individuals making more than one trip on only a few days.
47 This information is only available for three of FirstGroup’s operating companies.
48 This is Stagecoach’s general view of the whole of its UK operations. It considers that information from Manchester on the proportion of customers purchasing multi-operator tickets and research in Preston about interchange at the bus station is supportive of this view, but cannot be extrapolated to other geographic areas.
5.73 These figures show that day tickets are used at least twice a day on average. FirstGroup told us that the statistics suggested that a number of customers made multiple journeys, but that a large majority would be using tickets as a return. Overall, the figures suggest that a proportion of customers in these areas use day tickets for more than two trips per day, in particular in the West Midlands, Nottingham and Manchester. However, we are unable to determine from this data whether customers of day tickets in these areas are making repeat return journeys on one route, or whether customers are using more than one route in the network.

5.74 Some customers in the areas listed in Table 5.9 also appear to use weekly tickets for more than one return journey each day, five days a week, in particular in the West Midlands, Manchester, West and North Yorkshire and Dundee. FirstGroup told us that this was most likely to be customers making return journeys for one day on the weekend. We are also unable to determine whether customers of weekly tickets in these areas are using more than one route in the network (for example, using different routes on different days of the week). As noted in paragraph 5.72, there is variation across local areas as to how many journeys are conducted on each ticket, although we note that the figures suggest that in all areas at least a proportion of users make more than one return journey per day using day or weekly tickets.

5.75 Four of the Large Operators told us that they did not think that a substantial proportion of their customers used more than one route in their network, although they noted that they were limited in their ability to analyse customer usage of the network of bus routes. The other Large Operator, National Express, told us that in the West Midlands conurbation customers used its network of local bus routes, and its network was designed to be used in this way.

5.76 Stagecoach produced some customer research aimed at understanding how its customers use its Megarider tickets (Stagecoach’s multi-journey tickets). This survey suggested that per cent of Megarider ticket holders use more than one bus on a regular basis. This is broadly in line with the figures from our customer survey (53 per cent used more than one bus on a regular basis) although Stagecoach told us that this did not accord with its experience of Megarider tickets, and told us that the survey was subject to some limitations. Stagecoach’s customer research looked at how Megarider customers in Oxford and Cambridge used the network of services and found that per cent of Megarider customers in these towns made use of the network. Stagecoach attributed this to the layout of these cities, where there are a number of attractors at different locations.

5.77 Aside from this survey work conducted by Stagecoach, operators told us that their ability to analyse customer usage of their networks was limited. Go-Ahead told us that only its operating company measured use of season tickets in relation to journeys taken. Go-Ahead told us that figures from this operating company suggested that per cent of season ticket users used these tickets within one service corridor (ie as a repeat single or return ticket), rather than across multiple routes in a network—and so per cent are used across more than one route in a network. Two board papers from FirstGroup’s Glasgow operating company discuss the introduction of a ‘two journey’ ticket. One of these papers notes that, while another notes that this was. However, 

49 We have no further information on the individual travel patterns by customers using these tickets.
50 Go-Ahead.
Conclusions on customer usage of the bus network

5.78 The evidence in this section shows that a substantial proportion of revenue and trips is accounted for by non-single tickets. Similarly, the evidence also indicates that a substantial proportion of passengers make at least two trips per day as they buy multi-journey tickets (a return trip on an individual route in the case of return ticket users).

5.79 The evidence also suggests that a smaller, but still significant proportion of customers use more than one route in a network, as evidenced principally by our customer survey where we found that 53 per cent of fare-paying passengers used more than one route on a regular basis (see paragraph 5.65 above) and between 10 and 23 per cent of journeys involved more than one route (using evidence from the NTS and our customer survey, with different proportions depending on what tickets are used—see paragraphs 5.64 and 5.67). It is intuitive that in larger, more complicated networks, where different key destinations are in different locations, customers are more likely to need to use more than one bus route in the area to reach their desired destinations (either for that proportion of passengers that make interconnecting journeys or for passengers that use more than one route over the course of a week, for example), and this is supported by Stagecoach’s survey evidence (see paragraph 5.76). In addition, evidence from the operators on ticket usage in different local areas suggests that in the West Midlands, Manchester, West and North Yorkshire and Dundee customers are more likely to make more than one return trip per day. FirstGroup’s internal document from Glasgow [X].
6. Qualitative evidence on bus operators’ competitive strategies

Introduction

6.1 In this section, we set out the qualitative evidence that we have on the nature of competition between bus operators and between bus operators and other modes of transport. The evidence we rely on is drawn in part from parties’ submissions, hearings and responses to our market questionnaires. We have sought to complement this with a number of case studies that we carried out in summer 2010, as well as relevant internal documents provided by local bus operators, which have enabled us to explore in detail the competitive process in practice. Following the publication of our provisional findings, we received further evidence relating to the nature of competition between three of the Large Operators in certain parts of the reference area. That material is set out in Appendices 8.5 and 8.6, and discussed in paragraphs 8.175 to 8.234. Reference is made to this evidence as appropriate below.

6.2 Following our initial request for internal documents relating to the strategies of their local bus operations, we received varying amounts of documentation from each operator. We consider that this type of evidence can reflect closely the decision-making process taken by operators, as it is contemporary and produced by operators for the purposes of running their businesses. However, there are two limitations to its use within our investigation: first, there may be inconsistencies in the way managers record their decisions, such as different perceptions of the level of competition (which may not be representative of different actual levels of competition) and secondly, we may not fully understand the context in which the documents were produced. These issues are exacerbated in the local bus industry by the fact that operational decisions tend to be made at a local level. Whilst the first of these issues is inherent to the nature of this evidence and cannot be avoided, we have sought to address the second of these issues by asking operators to provide us with additional context to certain documents, where we considered it necessary for our understanding of the issues discussed in the document.

6.3 FirstGroup in addition argued that many of the rationales behind changes to bus operators’ local offerings might not be recorded in internal documents, particularly at operating company level. In particular, it told us that in its view the larger ‘prize’ for its operating companies was attracting car users and growing the market as a whole, and that this was so clearly in operators’ minds that it was often not necessary for it to be reflected in operating company documents. Arriva told us that its operating company papers were operational reports, rather than strategy documents, and that in general it did not manage its business with written documents. Arriva told us that operating company papers would often not comment on the ever-present competition from the car. In this section, we use Arriva’s operational reports as a source of evidence on the competitive decisions made by Arriva at the local level (and we note that all Large Operators, including Arriva, told us that their businesses were managed locally), but we also discuss some of Arriva’s strategy papers (see paragraph 6.59, for example) and other evidence on how Arriva analyses and changes its offering.

6.4 We accept that the generally accepted correlation between increasing car ownership and decreasing bus patronage is unlikely to be recorded. However, if, as stated by the Large Operators, achieving modal shift from car to bus is a key strategic objective and/or has resulted in specific actions or changes to operators’ offerings, we would expect this to be reflected in strategy documents, operational documents and/or

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1 In particular, both [●] and [●]’s operating companies produce detailed monthly reports. The other Large Operators appear to have significantly less extensive records.

6-1
board papers and for these papers to identify initiatives/actions aimed specifically at modal shift.

6.5 Most board papers shown to us focused on changes in circumstances, such as market entry, rather than broader market issues, and as such, provide a reliable insight into the strategies of entrants and responses of incumbents to new entry. We noted that the SWOT analyses included the identification of the car as a threat in a number of strategy papers produced by FirstGroup’s operating companies, but not in all. We also saw very few references to initiatives aimed at modal shift in the documents provided to us by parties.

6.6 We carried out case studies examining the supply of local bus services in 11 local areas. The case studies were focused on the competitive process between local bus operators and the impact of local conditions on competition, although we also received evidence relevant to other aspects of our investigation. The case studies relied primarily on oral evidence, which we obtained from relevant bus operators and local authorities between June and August 2010. Where available, we also used the internal records of the relevant operators and other primary sources of evidence in order to clarify points made by operators, particularly where their respective accounts of events differed markedly. We found that most parties were able to provide a detailed oral account of events. One operator, however, was less able to provide detailed evidence in this way and chose to give us additional evidence in writing, and for this reason, we relied more extensively on internal records and written evidence in order to obtain a fuller picture of its actions on the ground.

6.7 The approach we took allowed us to obtain evidence on specific issues on a systematic basis and from different perspectives. Nevertheless, despite our reliance on a range of both oral and written evidence, we found it difficult to establish some facts: often there were discrepancies in the factual accounts and opinions provided by different operators, other parties only had a partial knowledge of the facts and there were no public records that could be relied on. Although internal reports were on some occasions helpful in clarifying the intents and actions of operators, they could also be subject to interpretation.

6.8 In the rest of this section, we first set out the competitive strategies of the Large Operators, Mid-Sized Operators (both municipal and non-municipal) and a sample of Small Operators. We then explore how operators set their offering to customers and the evidence we received on the impact of ongoing head-to-head competition and the threat of competition on the way operators set their offering. Thirdly, we quantify the incidence of entry, expansion and exit in the reference area and describe the methods of entry adopted by various types of operators. Fourthly, we examine responses to entry from a range of operators. Finally, we summarize the qualitative evidence we have received on the constraint that other forms of transport, including the car, exert on operators’ behaviour. This section is supported by seven appendices, which set out the evidence we have received in more detail.

**Competitive strategies**

**Large Operators**

6.9 The Large Operators all told us that their strategy was primarily focused on organic growth, supplemented by targeted acquisitions. Although the degree of centralization varies between operators, operational decisions are largely made at the local level. Managing the relationship with local authorities was also a common feature of all these operators’ strategies. All the Large Operators told us that their actions were
constrained not only by head-to-head competition, but also by potential competition and competition from other modes of transport, in particular the car.

6.10 Additional evidence that is of relevance to our assessment of the Large Operators’ competitive strategies was received at late stage in our investigation. This information shows that in some areas certain Large Operators took actions to protect routes that they perceived to be within their Core Territories, on some occasions by responding to competitive incursions by retaliating on other routes. There is also evidence that the Large Operators communicated with each other about their respective commercial operations to a greater extent than we would expect to take place within the normal course of business. We have not received evidence allowing us to determine whether these types of behaviour apply more generally. Nevertheless they form an important part of our understanding of the competitive strategies of some of the Large Operators, and so the further evidence that we received—set out in Appendices 8.5 and 8.6, and discussed in paragraphs 8.175 to 8.234—should be read alongside the evidence that is presented in this section.

6.11 Arriva’s development strategy for its local bus services had three pillars: becoming the partner of choice of local authorities, a focused growth strategy centred on four explicit initiatives (effective marketing, holding down the price of multi-journey tickets, network relaunches, and its joint venture with Centrebus Holdings Ltd), and greater operational efficiencies. Arriva told us that its primary concern was the quality of its bus services (reliability and safety standards). It said that its desire to become the partner of choice for local authorities had led to the restructuring of the business with more managing directors appointed to develop better insights into local authority needs and nurture local authority relationships. Arriva told us that this strategy was set in the context of the challenges posed by car ownership (see paragraph 6.145) and pressures on public finance.

6.12 FirstGroup told us that it had grown its UK bus business through acquisition and organic growth over the last ten years. It told us that it did not operate in all towns and cities across the country, but that it perceived this as a growth opportunity. It noted that any such opportunities would need to be weighed against competing investment opportunities in other parts of its business and consequently it might have limited scope for further geographic expansion. Its key objectives in its 2008 Business Plan were to [ ]. FirstGroup told us that in line with its commercial strategy of delivering against its customers’ needs, it took decisions on how to compete or to react to competition by reference to longer-term horizons. It also told us that it faced a number of challenges including regulatory uncertainty linked to the concessionary fare reimbursement regime and changes to BSOG, and saw the bus industry ‘Greener Journey’ initiative, aimed at converting 1 billion car journeys into bus journeys, as a key opportunity. One objective identified in its 2008 business plan was to [ ].

6.13 Go-Ahead told us that the success of its business was based on locally-managed and fully-developed businesses, well-located depots, comprehensive and high-quality networks that were professionally marketed and good relationships with local authorities, all of which combined to produce high-quality bus networks for the communities they served. Its strategy for all its businesses relied on four core elements: prioritizing high-density urban markets in growing regions of the UK; providing high-quality, locally-focused passenger transport services; running group companies in a safe and socially and environmentally responsible way; and maintaining strong financial discipline.

6.14 National Express told us that it had a strategy of growth in the UK bus market, focused on the achievement of modal shift. It aimed to work more closely with local
authorities in order to improve the customer experience and to continue its efforts to convince local authorities proactively to support local transport and improve facilities for bus services, which it told us in turn drove growth in the demand for bus travel. Its strategy was also to make improvements in the quality of its services.

6.15 Stagecoach told us that following rapid growth through acquisition and a focus on achieving efficiency gains in the 1990s, it had realized that a change in approach was needed and had decided to focus on attracting car users. It had changed its business gradually. It simplified routes and instituted regular, and if possible high-frequency, services. It also simplified its ticketing offers, introducing its Megarider and Dayrider products, and ensured that its fares were competitive. Although Stagecoach still considered acquisition opportunities, acquisition was now not the main driver for growth. It said that its objectives today were to increase the number of fare-paying passengers and to contain unit operating costs. Its strategy to achieve these objectives was to offer simple routes, ‘clock-face’ timetables, a consistent ticket range and low prices supported by capital investment in new vehicles, high standards of service delivery and promotion, all delivered in partnership with the relevant local authority.

Mid-Sized Non-Municipal Operators

6.16 The following operators fall within this category: EYMS, Rotala, Transdev, Veolia and Wellglade.²

6.17 Transdev, Rotala and [X] all told us that their strategies involved growing their commercial offering and market share within existing areas of operation. Transdev told us that it was committed to increasing passenger numbers through marketing and brand development, for example developing web-based applications to appeal further to consumers. It also told us that it worked with local authorities and PTEs to deliver high-quality local bus services in the areas within which it operated, supported by ongoing investment in new or refurbished vehicles and efficiency programmes, particularly in driver training and fuel conservation. Rotala told us that its strategy was to gain market share by offering good-value and reliable services to the travelling public, in particular by achieving modal shift, and by gaining market share, owing to a superior standard in local bus markets compared with other operators. [X]

6.18 EYMS also told us that it aimed to attract more passengers by increasing frequencies where this could be justified, but that its overall strategy was to continue to provide as much of its network as possible while maintaining quality of service and generating sufficient profit to allow continued investment in the bus fleet and replacement of assets as necessary. EYMS told us that it aimed to try to consolidate its existing services by attempting to reorganize individual routes or corridor networks to serve the existing market better and/or reduce costs, and reduce non-contributing routes and journeys. It said that it would engage in marketing and fares promotions where cost-effective, but this was tempered by rising costs.

6.19 As noted in paragraph 3.51, Veolia operates mainly tendered rather than commercial routes. Veolia told us that historically it had made no efforts or plans to move into wider operation of commercial routes, and that this strategy was likely to continue in the current economic climate. It said that those commercial routes that it did operate were on a limited scale, mostly in Wales (largely inherited following acquisitions). Since 2009, Veolia’s focus in Wales had been to rationalize its operations, to create good networks and improve service quality.

² The merger of Veolia Transport SA and Transdev completed on 3 March 2011—see paragraph 3.43.
6.20 Only Transdev and Rotala discussed the possibility of expansion into new geographic locations as part of their commercial strategy:

(a) Transdev’s 90 per cent ownership of Bournemouth Transport Ltd meant that it was now looking at opportunities outside Bournemouth Transport Ltd’s boundaries under municipal ownership, particularly tendered services for Dorset and Hampshire County Councils.

(b) Rotala told us that in terms of further expansion, it was most efficient to buy businesses that operated within a triangular area of its operations (Bristol–Birmingham–Heathrow). However, it noted that in order to grow its business it was likely that it would need to move outside this area. Rotala acquired Preston Bus, an 85-bus operator of urban services, in January 2011.

(c) EYMS told us that it did not believe it was in its interests to start new competition against other bus operators as it thought such moves were unlikely to be viable, and losses on a new competitive venture could put other parts of the business at risk.

(d) Veolia told us that its Welsh business was likely to continue to be concentrated in South Wales, with key business areas remaining Cardiff and Newport. Although it operated to the west of Swansea, it saw the [ ].

(e) [ ]

**Municipal Operators**

6.21 As noted in Section 2, there are 11 municipally-owned operators in the reference area. We obtained detailed evidence from the five largest Municipal Operators (Blackpool Transport, Cardiff City Transport, Lothian Buses, NCT and Reading Transport) and from Warrington Borough Transport.

6.22 Municipal Operators generally told us that they focused on providing high-quality, low-priced services to the customers in their areas, and aimed to grow patronage organically within their areas of operation. However, Blackpool Transport told us that while it endeavoured to provide a wide network of services, it would have to reduce the resources employed, make redundancies and rationalize services over the next three years, as a result of declining revenue.

6.23 Several Municipal Operators also told us that their strategy was driven by the different objectives of their owners, compared with the financial objectives of other bus operators. Lothian Buses told us that it was expected to meet lower financial dividends than the returns private investors would demand and its shareholders expected it to provide a high quality of service for public transport users in the area. Lothian Buses told us that this enabled it to focus on quality, frequency of service and good value in its pricing structure as well as meeting its financial targets. Reading Transport told us that its strategy was agreed with its shareholder and in basic terms was to provide the best possible service at the lowest possible cost in its area of operation. NCT told us that as a result of its public ownership by Nottingham City Council, it was constrained to pricing at a level which was in the interests of Nottingham City Council’s public transport objectives. Nottingham City Council confirmed that as a shareholder, its main priority was making sure to provide passengers with the best accessible, high-quality, service, so its key concerns were keeping fares

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3 Cardiff Bus, Lothian Buses and Reading Transport.
relatively low and ensuring that the network was both highly accessible and comprehensive. Warrington Borough Transport, on the other hand, did not consider that its ownership structure impacted the way it operated. It also told us that whilst it had to be profitable, it viewed its operation as a network and tended to look at its services as a whole rather than as individual elements. It also said that as a result of LTA budgetary constraints, several Sunday contracts had been cancelled, which had led Warrington Borough Transport partially to subsidize Sunday services in order to maintain a seven-day-a-week operation. Warrington Borough Transport told us that its approach to competition would be to focus on the quality of its service (and it would not use partial subsidization in such circumstances).

6.24 Most Municipal Operators from whom we received evidence told us that they were focused on their existing areas of operations, and none of the Municipal Operators suggested that geographical expansion was part of its strategy. Reading Transport said that its strategy focused on Reading and the surrounding authorities. Lothian Buses told us that its shareholders did not expect it to extend its geographical sphere of operation to any significant extent, and that it focused on providing a high-quality bus service for the people of Edinburgh and the surrounding area. Cardiff Council, on the other hand, told us that it in no way constrained Cardiff Bus’s ability to expand beyond its usual areas of operation. Nottingham City Council also told us that NCT existed at arm’s length from it and so there was very little involvement and pressure put on it by the council, but noted that NCT could not borrow money in the same way as private bus companies could. Warrington Borough Transport said that although its focus was very much on the Warrington area, if a real commercial opportunity presented itself somewhere nearby, it would definitely consider it.

Small Non-Municipal Operators

6.25 As shown in paragraph 2.43, more than 1,000 Small Operators are active in the reference area. These operators differ in terms of their size, capability and strategies. Small Operators account for approximately 18 per cent of the supply of local bus services in revenue terms (as shown in Table 2.14) and we therefore considered that gaining an understanding of the competitive strategies of this large and fragmented group of operators was an important aspect of our investigation.

6.26 Our understanding of the range of strategies adopted by these types of companies is primarily based on submissions and/or oral evidence received from 25 companies of varying sizes. We set out details of the market positions and strategies of these 25 operators in Appendix 6.2. Some of them were interviewed during our case studies, which enabled us to explore in detail their interactions with other operators and with local authorities within a specific local context. A brief description of the market position of these 25 companies, shown in Appendix 6.2, Table 1, shows that our sample includes a broad range of Small Operators. We spoke to some of the largest of the Small Operators: Centrebus, McGill’s, Western Greyhound and Norfolk Green; recent entrants, such as Premiere Travel and Yourbus; and a number of Small Operators that have been supplying local bus services for many years, eg Moffat & Williamson and Sanders Coaches.

6.27 The strategies of the Small Operators from which we received evidence is generally to fill gaps in the supply of local bus services (usually following deregistrations of entire services or decreases in service frequencies by an established operator). Most

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4 Appendix 6.4—Cardiff, paragraph 45.
of the largest of the Small Operators we spoke to—in particular, Centrebus, Western Greyhound, Norfolk Green, Konectbus, Speedwellbus and Thames Travel—have used tenders as a platform for growth. In Scotland, McGill’s has grown significantly, mainly by acquisition, since 2001 and operates some commercial services in competition with Large Operators. Although they are among the largest of the Small Operators, these seven operators display varying levels of appetite for head-to-head competition with Large Operators, but generally avoid competing head-to-head with the Large Operators on entire routes. Some Small Operators (Premiere Travel, Yourbus, Norfolk Green, Speedwell Bus and Speedwellbus) have identified deficiencies in the services offered by incumbent operators, including some of the Large Operators, and launched de novo commercial services in head-to-head competition with them. Two other Small Operators, Shuttle Bus and Munro’s of Jedburgh, also told us that they would consider competing with larger operators if opportunities arose, but both considered that opportunities were rare. The majority of the Small Operators from which we received evidence appeared unlikely to expand considerably in head-to-head competition with larger operators: some focused on a specific niche and avoided head-to-head competition with Large Operators (eg Premiere Travel, Yourbus, Norfolk Green, Speedwell Bus and Speedwellbus); some were barely surviving (eg Shuttle Bus); some had little appetite for head-to-head competition with Large Operators (eg Moffat and Williamson, two operators in the Lancaster area); and some were limited in their ability to expand by financial or operational constraints (eg Sanders Coaches, Olympic Mini Coaches). The evidence we have received from our sample of Small Operators therefore suggests that most of them are unlikely to expand significantly in head-to-head competition against Large Operators.

How operators review their offering

6.28 In this section, we introduce the approach taken by operators to managing their existing portfolio of services, including the impact of head-to-head competition with other bus operators and the extent to which they appear to take account of the threat of entry and potential competition. As with the previous section, additional evidence relating to the conduct of three of the Large Operators which is relevant to our assessment of the impact of competition on how operators review their offering is set out in Appendices 8.5 and 8.6, and discussed in paragraphs 8.175 to 8.234.

Service differentiation

6.29 There is evidence that some operators seek to differentiate their services for different segments of customer demand. The evidence we have received suggests that this is not a systematic strategy across every operator’s areas of operation, since customer segmentation was not identified by any of the Large Operators as a strategic objective (although Go-Ahead has a policy of local branding) and we have only identified specific examples of differentiated services (which we set out in the following paragraphs). Some operators appear to target certain services on routes according to the levels of customer demand, or on those routes where they see greatest potential for growth.

6.30 In Newcastle, Stagecoach told us that it divided its network into three distinct categories: first, a very strong core network of high-frequency, predominately main road services going off into the various estates of Newcastle, where Stagecoach had focused on achieving growth by improving the services in terms of frequency, pro-

5 Different entity from Centrebus Holdings, which is a joint venture between the directors of Centrebus and Arriva—see paragraph 3.23.
6 The difference between threat of entry and potential competition is explained in paragraph 8.91.
motion and price; second, a secondary network of lower frequency services which tended to interconnect suburban areas and which complemented the very strong core network; and third, a tertiary, relatively small, network of local services going into small areas of population, characterized by narrow streets and small local shopping centres, which Stagecoach operated with Mercedes 709 minibuses which were cheap to buy and operate. Its Yorkshire operating company segmented its customers into two categories for marketing purposes: those that [X] and those that [X]:

[XX] These customer segments are [XX] better targets for concentration of marketing spend.

6.31 In Birmingham, National Express told us that it had made a commitment to Centro as part of its partnership work that it would provide vehicles less than five years old on the core network where there was greatest scope for growth. [XX]

6.32 In Nottingham, NCT and [XX] both approached the development and branding of their services on a route-by-route basis. [XX] NCT had a group of services collectively known as ‘GO2’, covering Arnold, West Bridgford, Bulwell and other specific areas of the city. GO2 was largely a high-frequency, modern, low-floor-level bus service which met all Disability Discrimination Act (DDA) requirements, serving key arterial routes. Alongside GO2 was a group of services known as ‘Nottingham Network’, which generally operated less frequently and for shorter time periods. Nottingham Network penetrated the local housing estates and often ran smaller buses to accommodate lower-demand services. These two brands complemented each other and dovetailed to form the integrated NCT network. NCT told us that in some respects, dividing services into GO2 and Network segmented the market into working and non-working customers. Within GO2 services, NCT further segmented between the more affluent areas of Nottingham and those which ran into estates of predominantly council property, with the interior of buses adapted to cater for different customer needs.8

6.33 Go-Ahead told us that it had a policy of local branding of its services, which it believed helped to increase customer loyalty. More specifically in the context of the Tyneside case study (Appendix 6.4, paragraphs 78 and 82), Go North East told us that it [XX] managed 50 brands reflecting the very local nature of demand. [XX] Go-Ahead told us that various parts of Tyneside required different approaches to price, quality and service levels.

6.34 Veolia told us that as part of the drive for quality, it had started to launch branded services, such as the Glider brand. This approach involved route-specific liveries, marketing and specific driver teams. Veolia believed that growth would be generated by drivers building a relationship with their customers.9

6.35 In some cases, operators told us that they had developed differentiated services designed to appeal to non-users (in particular car users) on certain routes:

(a) Stagecoach told us that it developed ‘Stagecoach Gold’ routes in Oxfordshire as a premium quality service to attract ‘non-typical bus passengers—slightly more affluent passengers’ (see Appendix 6.4—Oxford, paragraph 58).

(b) NCT told us that when GO2 (see paragraph 6.32 above) was launched in 2001, it was very much targeted at commuters and it estimated that, in 2009, between

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7 [XX]
8 Appendix 6.4—Nottingham, paragraphs 9 and 10.
9 Appendix 6.4—Cardiff, paragraph 77.
and \([\%]\) per cent of passengers on any particular GO2 service had a car available when using an NCT bus.

(c) \([\%]\)

(d) FirstGroup told us that in Swansea and York it had introduced the ‘ftr’ services in order to encourage modal shift\(^{10}\)—FirstGroup’s website that details these services emphasizes convenience (speed, frequency and reliability), style and comfort.

(e) Documents from FirstGroup in \([\%]\) show that FirstGroup invested in new buses \([\%]\) and to encourage modal shift, and FirstGroup told us that it spent a total of £\([\%]\) million on these new buses.

(f) A sales and marketing plan from FirstGroup in Hampshire and Dorset suggests the adoption of a market segmentation strategy in Southampton, involving the allocation of better-quality vehicles and higher fares on certain routes and uplifting quality, to encourage modal shift.

**Fares**

6.36 Details on the ticket types offered by different operators are set out in Appendix 6.7. Paragraphs 6.37 to 6.41 summarize key aspects of operators’ approaches to fare setting, more details of which can be found in Appendix 6.1.

6.37 Arriva, FirstGroup and Stagecoach offer a relatively standard fare structure across their operating companies, but there are some local variations. By contrast, each operating company within the Go-Ahead group has a different approach to pricing. The price of single and return tickets can be based on distance travelled or can be a flat fare. Operators told us that flat fares were more appealing to non-regular users, reduced boarding times and provided added security to the driver.

6.38 Large Operators offer a range of season tickets valid for either the entire operating area or discrete areas and discounted tickets for certain types of customers. Common time periods for which season tickets are available are one day, five days, one week, four weeks, three months, the academic year (for tickets aimed at students), 26/28 weeks and one year. Operators have been trying to encourage customers to purchase fewer single tickets and more season tickets mainly in order to encourage brand loyalty but also because it reduces on-bus transaction time and, according to Stagecoach, because season tickets generate greater demand. One method used to encourage customers to switch to season tickets has been to decrease the differential between the price of single tickets and that of season tickets.

6.39 Within local areas there are exceptions to the standard fare structures applied. This includes fares for certain categories of passengers (eg students, commuters), premium routes (eg airport links or limited stop services), fare structures designed to encourage off-peak travel and special fares or ticket types to encourage modal shift on certain routes. In response to our written questionnaire, operators also gave us many examples of reduced fares or targeted ticket types introduced as a result of head-to-head competition with other operators, some of which are also discussed in their internal documents (see Appendix 6.1, paragraphs 38 to 49).

\(^{10}\) Specifically, FirstGroup’s website refers to an aim to generate 10 per cent modal shift from the private car and an increase in patronage of 30 per cent over a five- to six-year period.
Fares are generally reviewed annually, with the exception of Transdev which reviews fares every six months. Reviews are primarily carried out in terms of route profitability and financial performance, but also take into account feedback on customer satisfaction. Operators told us that in reviewing fare levels they took into account cost factors, competition from other bus operators, prices for other modes of transport (including car-parking charges), local demographics and the local economic climate. FirstGroup told us that fares were influenced by a variety of factors including consultation with stakeholders, and its internal documents show that it conducts ongoing monitoring of stakeholder and local media reaction to its fares policy (and other aspects of its offering). FirstGroup’s internal documents also suggest that the most important rationale behind specific fares decreases is to respond to head-to-head competitors. More broadly, operators told us that their fares, fare structures, and ratio between fares of different ticket types are influenced by value for money considerations and stakeholders, for example child discounts offered in many larger urban areas are driven by the requirements of the LTA. Some operators, in particular FirstGroup and Transdev, also told us that they reduced fares on certain routes in order to grow patronage.

Fares are generally reviewed at network level, aside from route-level promotions. Arriva sets the same target levels for all its operating companies and routes. Stagecoach takes the same approach. By contrast, FirstGroup told us that it managed its business at route level, including its reviews of fares, punctuality, reliability, cleanliness and service frequency. Although the time taken by operators to implement fare changes varied considerably, from one week to six months, operators told us that such changes could (not as a matter of usual conduct) be carried out in a matter of days, and several operators told us that they had done so in response to fare reductions by head-to-head competitors. Fare promotions are common and carried out at the local level: we identified more than 150 fare promotions across entire networks and around 245 route level promotions over the three years to spring 2010. We did not establish a statistical relationship between promotions and either head-to-head competition, or car ownership in the surrounding area, as shown in Appendix 6.1, Annex 1.

Service quality

Service quality in the local bus industry can be assessed along a number of dimensions. For example, Arriva and FirstGroup conduct ongoing and regular monitoring of aspects of service quality, in the form of customer surveys. The most generally accepted measure of service quality is a combination of punctuality and reliability. This is a dimension of quality which is consistently monitored by FirstGroup across its operating companies as shown by its monthly board papers. Stagecoach also told us about the importance of good ‘service delivery’. We note that punctuality is a regulated aspect of local bus operations, which is also monitored by VOSA and that failure to meet the standards set by the traffic commissioners can result in financial penalties (see paragraph 2.65): since 2005 the Senior Traffic Commissioner has applied a benchmark for bus punctuality throughout Great Britain of 95 per cent of buses running no more than 1 minute early or 5 minutes late. Failure to comply can

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11 In general, there is no clear distinction between what can be classed as a ‘promotion’ and what is a longer-term reduced fare. We asked operators for details of ‘promotions’, and so what is included on our analysis depends on each operator’s interpretation of what constitutes a promotion. Most commonly, it appears that promotions in our data set lasted for around one month, but there are examples of shorter time-frame promotions (promotion for a week, or a series of one-day promotions, for instance), and longer time-frame promotions (lasting several months or even in a few instances longer). Another common promotional period is to coincide with school holidays. There are also a few examples of ongoing promotions, such as reduced price tickets attached to holders of local sports teams’ season tickets.
12 FirstGroup, Stagecoach, Plymouth City Bus, EYMS and ['].
13 This is supported by research carried out by Passenger Focus—see paragraph 5.24.
lead to a public inquiry and financial penalties of up to £550 per bus, and/or the removal or reduction of the number of operating discs.

6.43 Several operators also emphasized the importance of scheduling frequent\(^{14}\) services, particularly to attract commuters. Another related aspect of quality which has received some attention from bus operators in recent years is the shape of local bus networks, and whether routes are well connected and serving key destinations. Examples of initiatives focused on this aspect of quality include Stagecoach’s network reviews in Yorkshire (see Appendix 6.1, paragraph 76) and the reviews carried out by Centro in partnership with local bus operators in the West Midlands (see Appendix 6.4—Birmingham and Black Country, paragraph 68). Vehicle presentation is also considered important, as illustrated by FirstGroup’s FreshStart initiative, the aim of which is to ensure the cleanliness of vehicles. A number of operators also told us about the importance of driver attitude and training. Finally, low-floor buses appear to be generally considered preferable to step entrance vehicles (particularly in urban environments) and some informal partnerships with LTAs require investments in low-floor buses.\(^{15}\) A younger fleet is generally regarded as a sign of quality (although some operators told us that refurbished vehicles could be equally good). The operation of late night/Sunday services was also considered an important dimension of quality by certain operators, particularly some Municipal Operators (see Appendix 5.1, Table 2).

6.44 There is no common pattern for reviews of service frequency: some operators keep their services under constant review, while others review frequencies and timetables at set intervals. Most operators told us that it took 10 to 15 weeks to change frequencies, except for high-frequency services (as defined by the 1985 Act—see Appendix 12.1, paragraph 51) or in response to unexpected events. Operators told us that they took account of various factors to determine the frequency of their services including: passenger numbers; reliability/punctuality statistics; costs and profitability; as well as external factors such as planned road works, school holidays or new developments that drove patronage. Certain operators also took account of the views of LTAs. In Appendix 6.1, paragraphs 53 to 56, we set out in more detail how operators review their service frequency.

6.45 Reasons given to us for substantial frequency changes were mainly: to respond to head-to-head competition from other operators, to reduce costs, meet punctuality requirements, or to stimulate patronage. Operators occasionally carry out major reviews of entire networks, for a variety of reasons, including competition with other operators. FirstGroup carried out a series of local initiatives under the corporate banner of [\[]. Stagecoach’s review of its local urban networks in Yorkshire between 2006 and 2008 (see Appendix 6.1, paragraphs 43 and 76) followed its acquisition of local operators and, according to Stagecoach, resulted in more reliable, punctual and robust networks, but also higher patronage and increased profitability. The review of its Sheffield network took into account competition with FirstGroup. Competition with other operators can be the driver of certain reviews, as was the case with EYMS’s simplification of its Willerby and Cottingham network in competition with Stagecoach.

6.46 Some operators told us that decisions relating to the allocation of newer or improved vehicles to certain routes could be driven by the level of head-to-head competition on that route,\(^{16}\) or the threat of competition,\(^{17}\) but also by other factors, such as the

\(^{14}\) In the generic sense of the term.

\(^{15}\) As explained by Stagecoach in paragraph 63 of the published hearing summary (see: www.competition-commission.org.uk/inquiries/ref2010/localbus/pdf/stagecoach_summary_rhd.pdf).

\(^{16}\) For example, in Bournemouth, Transdev told us that it invested in 11 new buses to improve its offering on a route facing strong competition (see Appendix 6.1, paragraph 81).
existence of partnerships with the local authorities, or the stated objective to stimulate growth in an area. One operator’s internal papers stated that the roll-out of low-floor buses could generate patronage growth (particularly among concessionary passengers) of per cent in each of the first three years following their introduction on a busy route.

6.47 Some operators told us that relationships with local authorities were one factor taken into account when reviewing timetables and service frequencies, and we found specific examples where the relationship with the LTA had driven improvements in bus quality, often as a result of voluntary or statutory agreements:

(a) In Bristol, FirstGroup spent £ million on an upgrade of its fleet as part of a commitment to invest in new buses under the LTA’s Greater Bristol Bus Network Programme.

(b) There were several examples in FirstGroup’s internal documents of initiatives driven by its relationships with local authorities or by the fact that local authorities could take actions that could significantly affect demand for bus services: its operating companies in Hampshire and Dorset, Manchester and West Yorkshire improved their offerings (in terms of performance delivery or investment in new vehicles) in the hope of securing bus priority measures; FirstGroup’s internal documents from Sheffield also discuss increasing investment in vehicles on routes involved in a statutory quality partnership (referred to in paragraph 12.94), going beyond the requirements in the partnership to demonstrate FirstGroup’s commitment. Go-Ahead (Metrobus) told us that it invested in 14 new buses as part of a requirement of a Fastway Quality Bus Partnership.

(c) NCT told us that it upgraded its fleet to meet any changing obligations under local and national regulations as well as upgrading when it was commercially sensible to do so.

6.48 By contrast, in general, there seems to be an expectation that when certain commercial services become unprofitable, the local authority will take responsibility for tendering those services it considers to be socially necessary. For example, Stagecoach told us that in Tyneside demand served by its tertiary network (see paragraph 6.30) had steadily declined over the last ten years, and Stagecoach had consequently reduced the scale of its involvement in it. Some internal documents note that LTAs or local councillors are likely to be unhappy about service withdrawals, and some refer to consultations between bus operators and LTAs in relation to service withdrawals. However, we have not seen any evidence that the need to maintain a relationship with an LTA directly led operators to reverse decisions relating to service mileage reductions, although reputational damage more generally appears to be taken into account when making such decisions, at least by certain operators.

FirstGroup told us that the effect on the LTA relationship would be taken into account

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17 FirstGroup told us that it spent £ million on new buses in Glasgow, to grow the market, meet the objectives of the local authority and to combat overcrowding, which was leading to customers switching to other operators (see Appendix 6.1, paragraph 80). FirstGroup spent a total of £ million on new buses (see paragraph 6.35(e)).

18 For example, it upgraded its buses on Service 30 as part of the Ecolink initiative with Nottingham City Council.

20 FirstGroup told us that given the large number of routes it operated, withdrawal and subsequent tender bid by FirstGroup was a relatively infrequent occurrence, and that this was likely to become even less prevalent as local authority funding was reviewed. FirstGroup told us that it took account of the views of stakeholders in advance of withdrawing a route. Even if a local authority decided to offer a tendered service, there was no guarantee that FirstGroup’s operating companies would be awarded the contract and in many cases it would be awarded to another operator.

21 For example, the 17 October 2008 minutes of board meeting ‘cautioned against the potential reputational damage arising from the proposed frequency reductions and service withdrawals … a less severe reduction might be considered’.
upfront in the decision of whether to alter service mileage, so a subsequent reversal of this decision was not common.

**The effect of head-to-head competition on the way operators set their offerings**

6.49 In this section, we consider the qualitative evidence we have received on the impact of ongoing head-to-head competition on the operation of local bus services. We do not consider here short-term responses to entry, which are examined in the section on entry and expansion (see paragraphs 6.105 to 6.143) and, as mentioned above, additional evidence that is relevant to this assessment can be found within our discussion of geographic market segregation in paragraphs 8.175 to 8.234, and the references therein.

6.50 The section is organized as follows. First, we present the submissions made by the Large Operators; we then set out relevant evidence gathered in the course of our case studies; and finally, we summarize evidence found in parties' internal papers. Throughout this section, the focus is on route-level head-to-head competition, although some of the comments also apply to area-wide competition, where the degree of overlap between parties throughout an area is extensive (as is the case, for example, in Oxford).

6.51 Arriva told us that its primary concern was the quality of its bus services (reliability and safety standards). Its approach to quality and value for money was exactly the same, irrespective of whether or not it currently faced competition from other bus operators or the threat of competition.

6.52 By contrast, National Express told us that it primarily responded to competition by focusing on providing the regular and reliable service that it had advertised and registered with the Traffic Commissioner.

6.53 Stagecoach told us that where it existed, the constraint from head-to-head competition was another factor which Stagecoach had to have regard to when setting its offering, in addition to the standard constraints of potential competition and competition from other modes of transport. Stagecoach told us that if another mode of transport was already providing an effective constraint, it may not respond to head-to-head competition. Beyond this, it was difficult to generalize because the impact of the competitor on Stagecoach’s offering depended on local circumstances. It told us that fares and frequencies were the aspects of its offering which were most commonly adjusted in response to head-to-head competition. An alternative approach which it had previously adopted was to improve the quality of the vehicles on a route. It told us that where there were two head-to-head competitors with a fair degree of overlap, it offered weekly and monthly tickets and also longer-period tickets in some places in order to encourage passenger loyalty. If there were two operators on a strong route, each would tend to offer a competing weekly ticket. Echoing this view, Oxfordshire County Council told us that competition on price between Stagecoach and Go-Ahead in Oxford was mainly limited to season tickets used by regular travellers.

6.54 Because it was difficult to compete on price alone, Stagecoach aimed to promote its services in other ways, eg through the use of a distinctive livery. It might also run two different types of service on a particular corridor to meet the demands of different categories of passengers. Where it operated inter-urban services in competition with an intra-urban operator, it would offer Megarider tickets (as was the case in Cardiff (see Appendix 6.4—Cardiff, paragraph 27) and Coventry).
6.55 Stagecoach, however, also told us that in Newcastle, where it operated intra-urban services, it did not take account of the competition from inter-urban services in setting its offering (see Appendix 6.4—Tyneside, paragraph 124). This view was echoed by FirstGroup, which said that inter-urban and intra-urban services met different customer needs. Arriva told us that head-to-head competition between inter-urban and intra-urban services was by accident.

6.56 In both the Oxford and Nottingham case studies, we received evidence of competition on service quality in situations of long-term head-to-head competition. Stagecoach told us that improving customer service, staff training and driving standards were key elements of competition in Oxford. It also operated a fleet of hybrid buses and a wider span of services early in the morning and late at night as a source of differentiation from Go-Ahead, key elements of competitive strategy in . In the context of the Nottingham case study, Trent Barton told us that to differentiate its services from those of NCT, it allocated its best drivers and high-specification vehicles to a competitive service. Similarly, we received evidence that in Birmingham, National Express allocated better-quality buses to routes where it faced ongoing head-to-head competition from Diamond Buses.

6.57 We also received evidence that ongoing head-to-head competition led to lower prices and better service provision in the long term:

(a) Devon County Council told us that ongoing competition in north Devon had resulted in more buses and cheaper fares, and hence fairly buoyant patronage.

(b) Cornwall County Council said that fares were generally lower by about one-third on routes where there was competition compared with other routes in Cornwall.

(c) In King’s Lynn, weekly fares charged by both operators (FirstGroup and Norfolk Green) on a competitive route (route 42) appear to have settled at a level which is a third lower than elsewhere in King’s Lynn. Day and weekly fares in King’s Lynn are also significantly lower than other day and weekly fares charged by FirstGroup elsewhere in East Anglia, including in Great Yarmouth which had a similar level of weekly fare to King’s Lynn prior to Norfolk’s Green’s entry.

(d) Also in Norfolk, a Small Operator, Sanders Coaches, told us that head-to-head competition held fares down on the route where there had been long-term competition between itself and FirstGroup, eg FirstGroup had increased fares on other routes except for the one on which it competed with Sanders. FirstGroup also introduced special ticketing arrangements on that route.

(e) In Worcestershire, Worcester County Council told us that in the absence of competition, fares in Worcester would continue to rise, there would be a poorer quality of network and poorer density. It also stated that it welcomed competition, having witnessed its effect on fares and frequency in Redditch.

(f) In Bath, Bath and North East Somerset (B&NES) Council told us that following Wessex Connect’s launch of a service to Bath University in 2009, the price of

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22 Appendix 6.4—Oxford, paragraph 36.
23 Appendix 6.4—Nottingham, paragraph 65.
25 Appendix 6.4—Cornwall, paragraph 24.
26 See Appendix 6.4—North and west Norfolk, Table 2, which shows that as at October 2006, weekly fares in King’s Lynn and Great Yarmouth were set at £10. As at April 2010, the weekly fare was £6 in King’s Lynn, compared with £13 in Great Yarmouth.
27 Owned by Rotala.
bus travel on this route had decreased and FirstGroup had been forced to revisit its pricing, even though it still remained more expensive.

\((g)\) In the West Midlands, Centro told us that on certain corridors in the Black Country, where there had been competition for a number of years, this had led to fare reductions in certain cases,\(^{28}\)

\((h)\) \([\times]\) 

\((i)\) In Sheffield, ongoing competition between FirstGroup and Stagecoach since 2006 (the detail of which is set out in Appendix 6.1, paragraphs 43 to 45) has resulted in significant price reductions on the competitive routes, improved services,\(^{29}\) and improved vehicles.\(^{30}\) Stagecoach told us that while the total number of passengers using Sheffield bus services had declined since 2006, it believed that the decline would have been faster without the competition that had taken place.

6.58 Operational reports tend to be focused on operators’ short-term responses to entry and are less likely to provide explicit information about the impact of ongoing (or long-term) competition with other bus operators on their decisions. Nevertheless, the internal documents we have reviewed contain ongoing monitoring of other operators’ prices and service registrations. In addition, there are a few explicit references to the impact that ongoing competition with other operators has had on operators’ offerings:

\((a)\) At the end of 2007 in Yorkshire, Arriva implemented a 7 per cent fare increase across all services except the competitive services for which the fares were held at their existing level.\(^{31}\)

\((b)\) In Cumbernauld, FirstGroup estimated that competition with Stagecoach over a period of more than ten years led to prices being between \([\times]\) and \([\times]\) per cent lower than they would have been otherwise, although the document notes that these price levels might be unsustainable.\(^{32}\)

\((c)\) In Chester, following a period of more intense price competition with Arriva, FirstGroup’s Potteries operating company board report from April 2008 notes that \([\times]\). FirstGroup told us that these network changes were not exclusively restricted to routes on which Arriva and FirstGroup competed head-to-head, and that competition was not the sole driver for these changes. The nature of competition between FirstGroup and Arriva in Chester is discussed in detail in Appendix 8.6.

\((d)\) In Edinburgh, two of FirstGroup’s internal documents note that Lothian Bus’s fares (available across Edinburgh) impacted FirstGroup’s business, \([\times]\). The document notes that Lothian’s fares are available across the city, not just on routes where FirstGroup and Lothian competed head-to-head.

\((e)\) \([\times]\) subsidiary set price increases at least on two occasions by reference to those of Stagecoach.

\(^{28}\) Appendix 6.4—Birmingham and Black Country, paragraph 66.

\(^{29}\) For example, there is evidence of Stagecoach’s proactive consideration of new services, prompted by a drive to improve its competitive position against FirstGroup throughout Sheffield (eg its consideration of the Sheffield–Stockbridge service). Stagecoach also told us that it had concentrated on improving punctuality and the cleanliness of its fleet. Also see Appendix 6.1, paragraph 45.

\(^{30}\) Stagecoach invested in new low-floor vehicles. Also see Appendix 6.1, paragraph 45.

\(^{31}\) Arriva told us that this increase was on a number of services and was the first that had been implemented for a number of years, previous annual reviews having decided to hold fares constant.

\(^{32}\) \([\times]\)
All of Arriva’s fare strategy discussion documents used in pricing clinics conducted with each operating company set out competing bus operators’ prices as part of their analysis and some of the operations reports prepared by the operating companies also compared Arriva’s prices to those of competitors. We saw four examples of routes where Arriva’s prices were set by reference to or directly influenced by those of its main competitors. Arriva noted that the use of fare strategy discussion papers formed one of a number of inputs that influenced fare revisions, and that local management decisions were ultimately taken by the local management team taking into account a variety of local issues.

Corporate plans from [X] suggest that in response to ongoing competition from Stagecoach and Arriva in [X], [X] allocated new or refurbished buses to competitive routes in order to gain a competitive advantage. We have also seen evidence of an operator responding to competition by launching a new route served by older low-floor vehicles under a different livery—this evidence, in addition to further discussion of the nature of competition in the North-East, is discussed in Appendix 8.5.

The qualitative evidence we have gathered shows that ongoing competition between local bus operators manifests itself in various ways, depending on local circumstances. There is evidence that it can result in lower fares in the long term, possibly with discounts as high as [X] to [X] per cent in some places. Ongoing competition can also manifest itself in improvements in service quality, including the allocation of better or differentiated buses and the proactive management of service provision.

How operators take into account the threat of competition in setting their offering

In order to assess the effectiveness of the constraint posed by the threat of competition, we sought qualitative evidence on whether operators set their offering at a certain level or in a certain way in order to discourage entry on to the routes which they operate. We note that the effectiveness of the constraint posed by the threat of competition can be deduced to an extent from operators’ responses to entry (which is more fully discussed in paragraphs 6.128 to 6.142) and in particular that the lack of a response to an entry event which is followed by the exit of the entrant can indicate that the existing operator is constrained by potential competition, ie there is no gap in the market that can be exploited by a new entrant.

In the course of the case studies and our reviews of the Large Operators’ internal documents, we found no evidence that the possibility of a new operator setting up a depot nearby, ie ‘new entry’ (as defined in paragraph 8.104) was taken into account by operators. In particular, our review of internal papers showed that FirstGroup’s and Arriva’s operating companies only monitor the activities of other bus companies in their areas of operation. None of the strategy documents produced by these businesses mentioned the possibility of new entry by new operators into their areas of operation (ie entry by operators currently without existing services and facilities nearby) as a threat, unless a nearby small operator came up for sale, in which case they might consider the possibility that they would be acquired by a Large Operator and the risks associated with this. We therefore consider that the risk of new entry, as defined (see paragraph 8.104), is not an important consideration for the Large Operators, at least in advance of the general threat becoming a specific prospect.

33 Although one of these instances refers to a jointly-operated route, and Arriva told us that fares had to be revised in line with the other operator. We also note that we do not have information on the total number of routes where prices were examined.
34 Arriva told us that these internal papers were operational reports and did not document all the activities of its local operating companies, including annual fare reviews, even if fares were not ultimately changed.
35 FirstGroup told us that for its local operating companies to list every single potential competitor in their monthly board reports would be a huge exercise and of no commercial use. FirstGroup told us that this did not, however, detract from the fact that the
We discuss in paragraphs 6.64 to 6.72 the evidence on the constraint from potential competitors (with existing services and facilities nearby—see paragraph 8.104).

6.64 We reviewed the internal papers of Arriva, FirstGroup and Go-Ahead to assess further the issue of potential competition.36

6.65 Arriva’s internal documents contained some evidence that potential competition may have an impact on the day-to-day management of its services:

(a) Arriva monitors not only the actions of its competitors with which it is in head-to-head competition but also the actions of those present in the vicinity of its routes. When a potential competitor launches a service in competition with its existing services, Arriva first monitors the impact of this entry on its services before deciding on what action, if any, to take. Entry does not always result in a loss of revenue and the operating companies therefore do not always respond.

(b) One of Arriva’s operating companies ([X]) noted that a larger Operator ([X]) was intending to buy a Small Operator ([X]) and commented that ‘its well-placed [X] depot and school contracts’ provided a ‘foundation from which to attack [X] commercial services in Hertfordshire’. There is no suggestion elsewhere in Arriva’s board papers that [X] was perceived as a threat (although its registration of a half-hour service in competition with an Arriva service was noted). This may indicate that this operating company considered a larger operator ([X]) to be a more significant threat than a smaller one ([X]).

(c) Similarly, Arriva’s North East operating company noted the acquisition of Northumbria Coaches by Go North East in early 2007 and commented that this acquisition would give it ‘a springboard to register further competitive services against us in south east Northumberland’. It also took this into account in its South East Northumberland network review: ‘the overall design has had to be more defensive in nature as a result of the continuing competition by Go North East and the recent acquisition of Northumbria Coaches which has a large depot site in the area’. This suggests that prior to its acquisition by Go North East, Northumbria Coaches was perceived as a lesser threat by Arriva.

(d) Another example of a reaction to the threat of competition is provided by [X] comments on the entry of [X] into [X] (in contrast with the actions of other Small Operators, which did not appear to be perceived as serious threats by [X]):

This is a very serious threat to [X]… However, action to combat the threat has resulted in changes to existing provision and some changes provided for in the original review will still go ahead. To augment the services to [X] services, peripheral routes serving common corridors have also required attention with the added introduction of an express service between [X] and [X].

(e) In the Midlands, Arriva described Small Operators as ‘Jack Russell operators still nibbling at our ankles’, which suggests that it perceives them as a nuisance, but not as a threat.

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36 [X]

significant number of operators present in the reference area, that could enter against FirstGroup if it left any ‘gaps’ in its services, required it constantly to review its services to ensure that it met its customers’ needs. However, were the threat of new entry (as opposed to potential competition) considered a significant threat, we would expect to see some reference to it in FirstGroup’s internal documents. In addition, the fact that FirstGroup modifies, in some instances, its behaviour in response to potential competition or notes the risks of takeover of a nearby small competitor by another operator suggests that the constraint from new entry is not an important consideration.
6.66 Our review of FirstGroup’s internal documents showed that FirstGroup’s operating companies monitor the registrations made by other local bus operators in their area of operation on an ongoing basis. Board reports from September 2007 for First Potteries and First West Yorkshire note a UK Bus Board action for all operating companies to ‘look at where any potential competition would come in to operate and formulate a plan for defence. Operating companies must concentrate on the service delivery and improve performance in order not to allow competition into any gaps.’ One document from Halifax noted that ‘[•••]’. Several documents prepared by FirstGroup’s Manchester operating company suggest that there is a constraint posed by the threat of potential competition: when considering fare increases, it identified potential competition as a risk, and when it evaluated service withdrawals and frequency reductions, FirstGroup considered responses from nearby competitors. Mitigation actions were also envisaged. The qualitative evidence we received suggests that the size of potential competitors has a bearing on FirstGroup’s operating companies’ responses to potential competition.

6.67 When a Small Operator entered or expanded on to FirstGroup’s routes, internal documents show that FirstGroup often monitored the impact of the entry or expansion on its business before deciding what, if any, response to implement, and if a response was implemented, it was focused solely on the route on which there was head-to-head competition and it did not seek to protect routes on which it did not face head-to-head competition but were within potential reach of the entrant. By contrast, in paragraph 6.68 below we present some instances where FirstGroup responded to the threat of competition from certain larger operators (ie a response not focused solely on the route on which there was head-to-head competition). In some specific cases, we have seen explicit statements that certain Small Operators are not considered a threat, for example:

(a) First Group’s Devon and Cornwall operating companies did not appear to consider Small Operators in north Devon as a threat: ‘[•••]’ (see Appendix 6.4—North Devon, paragraph 18).

(b) In ‘[•••]’, Small Operators were described as ‘[•••]’ by local management in 2007 (although the current management told us that they did not share this view) (see ‘[•••]’).

(c) In ‘[•••]’, a Small Operator, was described in one internal document as ‘only likely to represent a threat in the tendered market’.

6.68 The evidence suggests that potential competition from Mid-Sized and Large Operators poses a stronger constraint than that from Small Operators and has led to improvements in the quality of certain operating companies’ offerings to pre-empt entry or expansion. However, there is also evidence that this may not always apply, for example if the nearby larger operator has shown no appetite for head-to-head competition in the past or is known to have capacity constraints:

(a) A Small Operator in South Wales, ‘[•••]’, was perceived in one internal document by FirstGroup ‘[•••]’ as being ‘an annoyance’ ‘[•••]’. It was also noted that ‘[•••]’. Anticipating that Veolia would target ‘[•••]’ in the future, FirstGroup identified ‘[•••]’ as a mitigating factor for the £‘[•••]’ risk that would result from Veolia’s entry in that area.

(b) Following Stagecoach’s acquisition of Cooke’s Coaches, a Small Operator in Taunton which exclusively operated tendered services, FirstGroup increased frequency and improved vehicle quality on certain routes in the area, as a result of the threat of Stagecoach’s expansion on to those routes: FirstGroup com-
mented that: [X]. Following an assessment of Stagecoach’s operation in Somerset, [X].

(c) [X]

(d) Our review of the body of board and strategy papers produced by FirstGroup’s Devon and Cornwall operating company showed that [X].

(e) Hampshire’s internal documents also suggest that larger operators may be seen as a greater threat than independent operators: one of Stagecoach’s strengths was listed as being ‘[X]’; weaknesses of a smaller operator ([X]) were that it [X]; and weaknesses of an operator running a contracted university service were that it [X]. FirstGroup monitored Stagecoach’s and Go-Ahead’s (Solent Blue) nearby operations, and noted that these operators might expand into FirstGroup’s areas of operation, although Stagecoach’s ability to expand was viewed as restricted because of limited space at its depot. It was also noted that Go-Ahead (Solent Blue) was facing difficulties and struggling financially.

(f) In Berkshire and East Anglia, FirstGroup’s internal documents suggest that the presence of other Large Operators in the vicinity of its area of operation were not viewed as a threat by these operating companies at that time: ‘[X]’—see also Appendix 6.4—North and west Norfolk, paragraph 28.37

(g) We also noted FirstGroup’s comment that ‘[X]’ in [X]. This suggests that in [X], FirstGroup’s fares were not constrained by the presence of [X] on nearby routes.

6.69 Compared with Arriva and FirstGroup, Go-Ahead’s internal papers make few references to competition (whether head-to-head or potential) and, as shown in paragraph 6.139, Go-Ahead appears rarely to respond to the entry of smaller operators on routes on which it operates services, which might suggest that it is constrained by potential competition. We also saw some comments that suggest that potential competition has an impact on its operating companies’ decisions:

(a) Metrobus Corporate Plan 2010–2013 recorded the arrival and departure of two ‘low- inspiration operators who appeared to quickly exhaust their funding’ and noted: ‘trusting in our own high-quality offering we did not react to this competition, but allowed the passengers to decide’.

(b) [X] recorded that ‘the existence of two major operators in the [X] and the ongoing level of competition hampered the opportunity to improve profitability without ceding market share to [X]’, which suggests that the presence of competitors nearby was relevant to the operating company’s decisions. In its corporate business plan, the company assessed the risk of increased competition by other operators, particularly [X], to be medium and put forward two mitigating factors, the second one of which appears to be a response to potential competition: to ‘defend and counter-attack robustly, but proportionately to the aggression from the competitor’ and to ‘continue to build the quality of the current product to make it the first choice’.

(c) In [X], [X] per cent of [X] services face head-to-head competition, but the company’s business plan recognizes the competitive threat posed by [X] across the entire area and this translates in high levels of investment ([X]) and the

37 [X]
delivery of a quality service across the entire network, rather than just the competitive routes.

(d) In its business plan, [X] considered the competitive threat on its business to constitute a medium risk ([X]) and identified the comprehensiveness of its network and excellent reputation as mitigating factors.

(e) [X] considered the risk associated with competition to be [X] and identified three actions to mitigate this risk: ‘to monitor competitor activities, to consolidate/protect core network through pro-active changes and to react appropriately to competitive threats’. [X]

6.70 Stagecoach told us that it operated on the basis that if it served the market well in terms of the quality of delivery, frequency and pricing, it would not give the opportunity for potential competition to turn into actual competition. Go-Ahead echoed Stagecoach’s views and added that an operator’s reputation and track record in a given market would be a factor influencing the nature of any constraint from potential competition. Stagecoach told us that the threat of expansion might come from existing commercial operators or from tendered services operators that could begin operating commercial services. Stagecoach also told us, however, that it was sometimes not the case that an incumbent operator adequately served the market. It cited the example of Cavendish’s entry into Eastbourne where Eastbourne Buses was the incumbent operator (see paragraph 6.86) and entry was able to exploit ‘gaps’ in the incumbent operator’s network. It also cited the example of Reays’ entry in Carlisle to demonstrate that entry opportunities were not limited to existing routes, or times of the day/week, or timetables, and that new entrants could run services along different routes or to new destinations.

6.71 We received evidence from some Small Operators38 that they perceived both Stagecoach and Go-Ahead to be providing a quality, extensive service, which left no gaps for others to exploit. By contrast, one Small Operator ([X]) told us that, in its experience, FirstGroup had left gaps in its services in its area and that if anyone looked to fill those gaps or created a niche market it would respond very robustly and with apparently little concern for the losses it might incur in the process. Another Small Operator ([X]) told us that Arriva left some gaps and that FirstGroup left the most gaps. Another Small Operator ([X]) also noted that a common pattern in its area of operation was for FirstGroup gradually to reduce service frequency on routes that were not making it any money, and then to stop the service altogether.

6.72 The qualitative evidence we have seen suggests that potential competition from bus operators with facilities nearby can exert a constraint on local bus operators’ behaviour, although the strength of this threat appears to vary from one operator to another, and between the local operating companies of the Large Operators. The constraint posed by the threat of entry by Large and Mid-Sized Operators also appears stronger than the constraint posed by Small Operators. Recorded actions taken in response to potential competition tend to focus on avoiding gaps in service provision and other aspects of service quality, rather than fares. The qualitative evidence may therefore suggest that the constraint posed by potential competition is weaker in relation to fares than it is in relation to service quality, including frequency and network coverage.

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38 [X], Small Operators in Lancaster, [X].
Entry and expansion

6.73 In this section, we measure the incidence and scale of entry and expansion by local bus operators in Urban Areas. We then examine what methods of entry and expansion have been adopted by local bus operators, drawing on evidence gathered through our written questionnaires, our case study work, hearings with local bus operators and a review of internal documents. Further qualitative information that is relevant to our assessment of entry (in particular, suggesting that in some instances entry may have the objective of reinforcing geographic market segregation) is discussed in paragraphs 8.191 to 8.198.

Incidence and scale of entry and expansion in Urban Areas

6.74 We used two methodologies to estimate the incidence and scale of entry and expansion in Urban Areas. These methodologies are explained in Appendix 6.5, paragraphs 18 and 19. The first methodology matched the entry events that took place in the five years to spring 2010 (as reported to us by Large, Mid-Sized and Tier 1 Small Operators in response to our questionnaire) to Urban Areas. The second methodology uses Traveline information taken on two separate dates—October 2008 and October 2009—and considers changes in operators’ shares of supply across this period. Both methodologies have some limitations, as discussed in Appendix 6.5, but they both show similar results and, to our knowledge, we have used the best available data sets. They indicate that, as might be expected, larger-scale entry or expansion is rare:

(a) Using the first methodology, we found that 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. As shown in Appendix 6.5, most of the entry events by Large, Mid-Sized and Tier 1 Small Operators were of a small scale. Our sample of entry events from Tier 2 Small Operators’ questionnaire responses is incomplete. We note that by definition these operators account for less than 25 per cent of services in all Urban Areas in which they operate.

(b) Using the second methodology, we found that entry, exit and expansion/contraction events involving shares of supply of 10 per cent or more are less common than events involving 5 or 2.5 per cent. For example, we found that between 2008 and 2009, approximately 4 per cent of areas experienced an entry event involving a change in share of supply of 10 per cent or more, while approximately 17 per cent of areas experienced an entry event in the period involving a change in share of supply of 2.5 per cent or more.

6.75 The first methodology suggests that the great majority of Urban Areas (88 per cent) did not experience entry by Large, Mid-Sized or Tier 1 Small Operators in the five years to spring 2010, and 96 per cent did not experience any entry from a Large Operator. As noted in paragraph 6.74(a), we received evidence from only a sample

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39 For some of our analysis and data gathering we have distinguished between two categories of Small Operators. Tier 1 Small Operators are those that are at least the second largest operator in at least one Urban Area with a share of supply of at least 25 per cent, according to our analysis of the Traveline database. All other Small Operators are called Tier 2 Small Operators.

40 The first methodology does not define the scale of these entry events precisely, but notes that in the working paper on methods and history of entry and exit, the mean scale of entry was 20 buses or three routes. Most entry events involved substantially fewer routes and buses than this—in particular, 60 per cent of all entry events involved fewer than six buses and 72 per cent only one route. The share of entry events involving three routes or fewer is 86 per cent; see Table 7 in that working paper. The second methodology discusses entry events involving changes in operators’ share of supply of various sizes.

41 These shares of supply relate to the proportion of total weekly services (i.e. scheduled journeys) on all routes that cover a distance of at least 500m in an Urban Area that are served by a given operator, and have been calculated using the Traveline database.
of Tier 2 Small Operators and hence were not able to calculate the proportion of Urban Areas that have experienced any entry by these operators using this methodology. However, the number of entry events by Tier 2 Small Operators is included in the calculations we performed using the second methodology: we found that the great majority of Urban Areas did not experience any entry over the course of a year that involved a substantial change in the share of supply. For example, our analysis shows that over 90 per cent of Urban Areas did not experience any entry event that involved a change in share of supply of 5 per cent or more between October 2008 and October 2009. We also found that the overall share of supply in the reference area controlled by the ten largest operators varied very little between 2008 and 2009 (see Appendix 6.5, paragraphs 33 and 34). Using responses to the market questionnaire from Large Operators, we also calculated the proportion of their routes that experienced entry or expansion against them, and this analysis similarly takes into account all Small Operators. We found that entry or expansion occurred on only a very small proportion (less than 3 per cent) of the Large Operators’ routes.

**Methods of entry and expansion**

6.76 Several operators told us that entry could be incremental and FirstGroup identified several entry and/or expansion models that it had used, including: increasing frequencies of existing services; revising networks (eg to compete on a simple high-frequency basis, to serve new destinations or to refresh its appeal to the market); launching new services in competition with an existing operator; acquiring another operator; tendering for contracted services (and also using this as a springboard into commercial operation); and other types of services including airport services, park-and-ride services and demand-responsive contracts.

6.77 Other parties, eg Arriva and National Express, particularly stressed the significant impact on larger incumbents of small-scale entry focused on ‘cherry-picking’ the most profitable routes.

6.78 The methods of entry and expansion that the Large and Mid-Sized Operators told us they had used were: increasing frequency on existing services, extending existing routes (either to new locations or increased hours of operation), expanding capacity on a route with larger vehicles; operating new commercial vehicles from existing depots; winning tendered service contracts; acquiring other operators (in totality or just some routes/services); building a new depot, from which they launched new commercial routes; and obtaining funding from government or third parties.

6.79 We were made aware of 62 entry events into new areas\(^{42}\) that took place in the five years to spring 2010 and that were carried out by the Large and Mid-Sized Non-Municipal Operators, as well as [\(\ldots\)]. The information provided on these entry events showed that the two most common methods of entry were the acquisition of another local bus operator and the launch of de novo commercial services, followed by the award of tendered contracts (see Appendix 6.5, Table 4). Although incomplete, the data suggests that entry tends to be small scale (usually on one route and involving fewer than ten buses). Large-scale entry, ie exceeding 30 buses, was achieved by acquisition only (see Appendix 6.5, Table 7).

6.80 We received evidence that the simultaneous award of a large number of tenders or the award of a large contract (such as a park-and-ride scheme or university contract) could justify building a depot in a new area and thus provide a springboard for new commercial services. However, one of the Large Operators (Stagecoach) told us that

\(^{42}\) As opposed to ‘expansion within existing areas’, which is covered in paragraph 6.79.
such opportunities were not common. We identified from local bus operators’ responses nine occasions in the five years to spring 2010 when the scale or number of contracted services put out to tender was sufficient to support the case for a new depot, and three occasions when it could support an outstation. Of these 11 opportunities, seven resulted in the opening of a depot and one in the opening of an outstation. In only three cases (Barnstaple, [●], and [●]) has the operator also successfully developed commercial services.

6.81 Operators identified 638 instances of expansion within existing areas by Large and Mid-Sized Operators and [●] or entry/expansion by Small Operators. Of these, 486 were carried out by the Large Operators and 241 were in competition with another bus operator. On average, expansion events involved 12 buses and four routes. The most common methods of expansion within an area were: launching new commercial services; increasing the frequency on existing routes; and acquisition, as shown by Table 6.1. By far the most common method used by the Large Operators was frequency increase (135 expansion events).

<table>
<thead>
<tr>
<th>Expansion type</th>
<th>Number of expansions</th>
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<tbody>
<tr>
<td>Launching new commercial services</td>
<td>141</td>
</tr>
<tr>
<td>Increase in frequency on existing route</td>
<td>139</td>
</tr>
<tr>
<td>Acquisition</td>
<td>94</td>
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<tr>
<td>Won tendered contracts</td>
<td>91</td>
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<tr>
<td>Extend existing route</td>
<td>59</td>
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<tr>
<td>Expansion from third party funding</td>
<td>15</td>
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<tr>
<td>Extend hours/days of operation on existing routes</td>
<td>9</td>
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<tr>
<td>Increased vehicle capacity</td>
<td>10</td>
</tr>
<tr>
<td>Other/undefined</td>
<td>80</td>
</tr>
</tbody>
</table>

Source: Arriva, FirstGroup, Go-Ahead, National Express, Stagecoach; Mid-Sized Operators; Small Operators.

6.82 Although the data is incomplete, it suggests that in the vast majority of cases the de novo expansion of commercial services is small scale, ie it involves fewer than ten buses. The evidence suggests that in the five years to spring 2010, there were nine occurrences of de novo expansion of commercial services requiring more than ten buses. This includes: a Kickstart scheme in Cambridge; support for the Kent Freedom Scheme; investment in [●] buses in Grimsby, although it is unclear how much of this was a fleet improvement and how much was for capacity expansion; the relaunch and gradual expansion of Stagecoach’s Sheffield network between 2006 and 2010; and the five-year expansion of a service in Nottingham linked to the growth in the student population.

6.83 In addition to the above five cases, over the last five years, there have been four cases of rapid organic expansion requiring more than ten buses by an operator of inter-urban services (or a nearby operator) into commercial urban services. In all four cases, this development was either followed by, or took place at the same time as, the sale of the incumbent operator of the urban network: the expansion of Arriva in Chester in mid-2007; the expansion of Stagecoach in Preston, also in mid-2007; the expansion of Cavendish Motor Services Ltd (Cavendish) in Eastbourne in 2008; and

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43 [●], [●], [●], [●], [●].
44 [●], [●].
45 For all Small Operators other than [●], we were not able to separate out entry events from expansion events and treated all such events as expansion events.
46 Some of the operators’ data on whether expansion was in competition with another operator is incomplete.
the expansion of FirstGroup in Plymouth in October 2009. We summarize the four cases briefly below.

6.84 Arriva’s expansion in Chester was the subject of litigation in 2007. The judgment\(^{47}\) sets out the facts of the case. Prior to its expansion, Arriva operated most inter-urban services in and out of Chester. The council-owned bus operation, Chester City Transport (CCT), operated the Chester urban network. In August 2006, Chester City Council announced its decision to sell CCT. In September 2006, Arriva registered duplicate services (ie identical services, including identical timetables) on all of CCT’s existing services with the declared intention of operating them from 7 January 2007. Arriva followed the registrations with a written offer to the council to acquire CCT’s assets and undertaking without taking part in the bidding process initiated by the council. The council rejected this approach. The judge noted that ‘as it was put at the trial, [Arriva’s] stance would be regarded as a gun to the Council’s head: “deal with us—or else” was something that was predictably likely to scare off other bidders for CCT (paragraph 65)’ and ‘it is obvious that Arriva’s threatened actions would have been perceived as likely to have an effect on a bidder’s consideration of the opportunity to acquire CCT (paragraph 75)’. In October 2006, the council had started court proceedings\(^ {48}\) and by late November 2006 Arriva withdrew some of the registered services and decided to compete with CCT on three of the most profitable major routes, with the new registrations coming into effect on 22 January 2007.\(^ {49}\) CCT was sold to FirstGroup in July 2007. More detail on the facts of the case can be found in Appendix 6.6, paragraphs 6 to 11 and a discussion of the impact on competition of the acquisition is set out in Appendix 8.6.

6.85 The events preceding the sale of Preston Bus Ltd (PBL), an employee-owned operator, to Stagecoach in January 2009 are set out in the CC’s report on the merger.\(^ {50}\)

Shortly after a meeting between Stagecoach and PBL in July 2006 at which PBL rejected Stagecoach’s expression of interest in an acquisition of PBL, Stagecoach developed a plan for expansion in the Preston area and less than one year later launched five services largely duplicating PBL’s most profitable commercial routes … PBL’s financial position deteriorated rapidly in the months that followed and its owners were ultimately left with little choice but to sell PBL to Stagecoach.

Prior to its expansion in Preston, Stagecoach had operated nearly all of the inter-urban services to and from Preston and two routes joining Preston to the nearby town of Penwortham.

6.86 Cavendish’s expansion in Eastbourne is detailed in the CC’s report on the acquisitions of Eastbourne Buses Limited (EBL) and Cavendish by Stagecoach.\(^ {51}\) Cavendish started operating buses in Eastbourne in 2006, using three second-hand buses. By March 2008, it had grown to 13 buses, and by 2008, this had increased to 28 buses. The CC found that the rationale for Cavendish’s entry and expansion in the Eastbourne area had been to exploit gaps in EBL’s network, to seek to displace EBL as the main network operator, or to force a sale of Cavendish to EBL’s owner.

\(^{47}\) Chester City Council & Anor v Arriva Plc & Ors [2007] EWHC 1373 (Ch), 15 June 2007.

\(^{48}\) It was alleged that Arriva had abused a dominant position by threatening to ‘flood’ bus routes and selling below cost in order to drive CCT out of business.

\(^{49}\) A court order, however, restricted Arriva’s ability to launch these services during the court proceedings and they were only launched in July following the judge’s decision.


Stagecoach acquired the two companies in 2009. Both EBL and Cavendish had been suffering heavy losses for a number of months.

6.87 In Plymouth, FirstGroup expanded its intra-urban operations in three distinct phases from 2007. The first two phases are well documented in FirstGroup’s internal records and followed a strategic assessment of FirstGroup’s competitive position and growth opportunities in Devon, which FirstGroup’s Devon and Cornwall subsidiary carried out in 2007. The expansion plan was prepared in November 2007, as part of a strategic review of FirstGroup’s position in Devon and Cornwall, which considered growth opportunities in Exeter, Torquay and Plymouth. Plymouth was identified as the most favourable town for expansion by comparing the size of the market, the ease of entry, the costs of entry, the extra revenue from existing services and the strength of the incumbent operator, including access to financial resources. The plan proposed two phases of development: a network review the scope of which was to improve FirstGroup’s current network in Plymouth, and which was thereafter branded as ‘Ugobus’ (phase 1), to be followed in May 2008 with expansion into two to three areas operated by Plymouth City Bus areas, with a peak vehicle requirement (PVR) of 10 to 12 buses (phase 2). One document noted that the second phase of expansion would be a ‘defensive measure’. FirstGroup told us that this was a ‘fall-back’ option to justify making the significant investment should the expansion not generate the expected returns on more profitable routes. Having carried out phase one in April 2008, which a subsequent document from July 2009 notes was ‘well received’, FirstGroup further assessed options for its phase two and proceeded with the launch of one route (service 11) using four buses in one new area of Plymouth in September 2008. The May 2008 Quarterly Business Review identified a third phase of the Plymouth Network Review, which was to involve ‘further extensions of the Plymouth network to areas such as [●]’ in 2010/11. We noted that in its 2008 business plan, FirstGroup’s local management in Devon and Cornwall considered the potential acquisition of Plymouth Citybus by a competitor as ‘[●]’. In July 2009, minutes of FirstGroup’s Devon and Cornwall operating company board meeting noted that Plymouth City Council had announced its intention to seek a valuation for Plymouth City Bus, that it was expected that the business would be sold and that FirstGroup had registered its expression of interest. It was also recorded in those minutes that proposals for a further expansion of the Ugobus network were to be sent to the UK Bus Board for approval. We understand that FirstGroup stopped operating its new Ugobus service 11 (launched in September 2008) in the evenings around this period and that by August 2009, this service was making a positive contribution. The only other contemporaneous document we saw relating to the third phase of development was a proposal submitted to the UK Bus Board on 8 July 2009 for the launch of six routes (four in competition with Plymouth Citybus and two new routes), requiring 35 additional buses and 65 additional drivers. This proposal identified the most lucrative Plymouth Citybus routes (which FirstGroup told us served areas that were good bus territory) and proposed services that competed head-to-head with these routes, but with some variations in the route taken, with two routes described as ‘completely new style’ routes. The proposal noted that there were various risks to expansion: [●]. In October 2009, FirstGroup launched four services using 24 buses. We understand from Plymouth Citybus that this was accompanied with a ticket discount scheme of £1 per journey on competing services for two weeks and a limited offer of 12 months’ travel for the price of six. We are not aware of any document explaining why it was decided not to launch two of the planned routes. FirstGroup told us that, given resources available at the time, it selected four routes on which it considered it would get the highest returns. Plymouth Citybus, however,

52 FirstGroup told us that this was because it considered that a competitor would likely invest in marketing following acquisition and would also be looking to generate a return on investment, making it harder for FirstGroup to differentiate its services and meaning that FirstGroup would lose revenue share.
told us that FirstGroup’s four new routes were very similar to those that it operated and covered the same roads, although they were slightly less frequent and did not operate during the evenings. This suggests that FirstGroup abandoned the two new routes and decided to concentrate on the four competing routes. Plymouth Citybus estimated that the increased level of competition from FirstGroup [\(\times\)]. Plymouth Citybus was sold to Go-Ahead in December 2009 and in February 2010, FirstGroup reduced the frequency of three of the services that it had introduced in October 2009.

6.88 We also saw a strategic review prepared for one of the Large Operators ([\(\times\)]) assessing the future competitive situation in a mid-size town ([\(\times\)]), where the operator of intra-urban services is owned by the local council and the Large Operator in question operates the majority of inter-urban services in and out of the town. The report examined, inter alia, means by which the municipally-owned operator could be purchased: a ‘friendly’, negotiated sale, a ‘sealed bid’ sale by tender, a ‘hostile’ sale and a ‘distress sale’. We noted the following comments:

It may be that a meaningful discussion with [\(\times\)] Council about a sale of [\(\times\)] could be instituted if [\(\times\)] mirrored even a small part of [\(\times\)]’s commercial operation. For example, it would take only a small presence of three [\(\times\)] buses to replicate [\(\times\)]’s presence on its smallest commercial route … Other, or alternative, demonstrations of presence could in a bidding war, assist in deterring other parties from bidding and ‘a distress sale could arise if [\(\times\)]’s trading position became untenable as a result of a substantial mirroring of all or part of the [\(\times\)] operation’. The Large Operator told us that these comments represented neither its views nor its policies and that the report it had provided to us had been prepared by an independent consultant. We accept that the strategic options put forward in this report may not have reflected the operator’s views. We considered, however, that the options outlined in the report were likely to be credible (otherwise they would not have been presented to this operator) and it was likely that the operator had given some consideration to them. We also acknowledge that the proposals were not acted upon.

Methods of entry and expansion adopted by the Large Operators

6.89 We were made aware of 486 expansion events by the Large Operators within their existing areas of operation in the five years to spring 2010. 40 per cent of those (or 195 events) concerned the expansion of existing routes (either in terms of frequency increases, extensions, or increases in vehicle capacity). Only 16 per cent of expansion events related to new commercial services, with a similar number relating to tendered services. In 14 per cent of cases, expansion was by acquisition.

6.90 We were made aware of 46 entries into new areas and 64 exits from areas by the Large Operators in the five years to spring 2010. Thirty-eight of the 46 entry events were identified as being against at least one competing operator, and of the 64 exits, 53 were identified as being in areas where the exiting operator faced competition.53 Twenty of the entry events by these operators were by introducing commercial services, 12 by acquisition, 13 by winning tendered contracts and one by a combination of tendered and commercial services. Operators identified that 15 areas had subsequently been exited. The scale of entry was modest, with 21 of the 29 entry events where we have information on the number of routes being on one route. Similarly, of the 46 entry events where we have information on the number of buses involved, 26 involved five or fewer buses and only five entry events involved more than

53 Some of the operators’ data on whether the entry or exit was in competition with another operator is incomplete.
100 buses. Acquisition was the only method of entry used for entry events involving more than 30 buses.

6.91 In the following paragraphs, we examine the Large Operators’ expansion with commercial services in new areas in the five years to spring 2010.

6.92 Arriva told us about ten instances of expansion with new commercial services in new areas, five of which were in Staffordshire, Shropshire and areas around Leicester, two of which were in west Scotland, one of which was in the North-West, one of which was in the North-East, and one of which was in Chester. This included the acquisition of two small independent operators. Most de novo entry events relayed to us by Arriva were at route level, using a small number of buses (fewer than five), and all were from existing Arriva depots in nearby areas. As discussed in paragraph 6.84, the expansion in Chester was on a larger scale, involving ten PVRs, and was linked to the announcement by the council that it would sell its bus operation, CCT. The primary reason quoted by Arriva for launching the majority of its other new commercial services was the identification of a new market or growth potential (although Arriva’s evidence set out in Appendix 8.6, paragraph 66, indicates to us that its registrations in Leicester were retaliatory in nature—we discuss the role such retaliation plays in competition between bus operators in paragraphs 8.191 to 8.198). Most of Arriva’s new commercial services were in competition with other operators. In a small number of cases, the poor reliability of the existing service, deregistration of services or frequency reductions were quoted as the competitive rationale for entering the route. Several of the new services ([]) were unsuccessful. Actions from other operators were never quoted by Arriva as the reason for exiting any of these routes.

6.93 FirstGroup told us that during the recession, with a few exceptions such as its Ugobus services in Plymouth (see paragraph 6.87), it had not actively considered any expansion because of the challenging economic circumstances. Prior to that, difficulties in recruiting and retaining drivers and engineers had made it impossible to expand services or enter into new markets to any significant degree.

6.94 FirstGroup’s expansion of commercial services in new areas in the five years to spring 2010 has been limited to:

(a) the acquisition of assets to operate a service to Glasgow Airport, which it later withdrew due to the recession and its declining appetite for risk;

(b) expansion in Lanarkshire (Carluke, Caldercui, Shotts, Glenboig & Gartcosh, Lanark, Holytown and Clyde Valley), some in competition with Small Operators. Around half of these services were subsequently withdrawn, and most of the remaining services were replaced with extensions of other services. One successful service was extended; and

(c) expansion in Largs, in competition with McGill’s. FirstGroup had since then withdrawn from the route.

6.95 FirstGroup also identified two areas where it entered through winning tenders, Cardiff and Liverpool, as providing growth opportunities, but in both cases it had not to date launched any commercial services (but had experienced continued tender expansion) and in the case of Liverpool, it had withdrawn following the loss of the contracts.

6.96 In the five years to spring 2010, FirstGroup considered entering new areas on four occasions ([]), but ultimately decided not to proceed at that time.
In the five years to spring 2010, Go-Ahead entered into two new areas, Plymouth and Norfolk, by acquisition.\textsuperscript{54} In both areas, the acquired operators had been involved in both commercial and tendered services and had been in head-to-head competition with FirstGroup on a number of services. Its Go North East operating company also set up an outstation to serve the Peterlee development. Other expansion by Go-Ahead was either in existing areas of operation or through tendered services (eg Plymouth Citybus expansion into west Devon). Go-Ahead also entered the West Midlands by acquisition, but subsequently withdrew from this area.

National Express has not entered any new area in the five years to spring 2010.

Stagecoach told us that it had entered into eight new areas\textsuperscript{55} in the five years to spring 2010, of which seven were by acquisition (the Highlands, Somerset, Liverpool, Yorkshire, Lincolnshire, Tayside, and Eastbourne) and one by establishing a new depot (in Barnstaple, Devon) from which it had operated both tendered and commercial services. Stagecoach also assessed a further [\textsuperscript{\textastertilde} \textsuperscript{\textastertilde}] acquisitions, [\textsuperscript{\textastertilde} \textsuperscript{\textastertilde}] opportunities that could have supported new depot bases, [\textsuperscript{\textastertilde} \textsuperscript{\textastertilde}] opportunities that could have supported a new outstation and the possibility of starting a new route, but these did not proceed.

Stagecoach’s entry and expansion in north Devon is detailed in Appendix 6.4—North Devon, paragraphs 26 to 33: having won a sufficient number of tendered services to justify opening a depot, Stagecoach launched a limited commercial service in head-to-head competition with FirstGroup, using the vehicles which were otherwise allocated to school services. Over the following four years, it progressively built up its patronage and invested in new vehicles. By 2010, the quality and coverage of its service matched that of FirstGroup, although elements of differentiation remained.

In 2006, Stagecoach acquired Yorkshire Traction, which had operations in Yorkshire, Lincolnshire and Tayside. Following the acquisition, it revised its Sheffield network with the objective of improving the scale and profitability of the Sheffield operation in the medium to long term. It sought to increase the number of passengers by modal shift, organic passenger growth and improving its market share against FirstGroup. This was to be achieved by creating new routes which provided new links and served some new roads, increasing frequencies, route extensions, investment in new low-floor vehicles, value-for-money fares and tickets, improved punctuality/reliability and service quality, staff training, customer initiatives, strengthened integration with the tram services and extensive and innovative marketing. The competition between Stagecoach and FirstGroup that ensued in the following years is detailed in Appendix 6.1, paragraphs 43 to 45.

The evidence therefore shows that 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. Arriva’s entry into new areas was confined to a few routes, some of which were in competition with other Large Operators; FirstGroup’s entry events have been concentrated on areas around Glasgow and have not been in competition with any of the Large Operators. National Express has not entered into any new area.

\textsuperscript{54} Plymouth Citybus and Konectbus.

\textsuperscript{55} Three of these areas were entered as part of the same acquisition of the Yorkshire Traction Group.
Methods of entry and expansion adopted by Mid-Sized and Small Operators

6.103 Although incomplete, the data we have received suggests that entry and expansion by Mid-Sized and Small Operators has been mainly by acquisition and by launching new commercial services (see Appendix 6.5, Tables 5 and 11).

6.104 We carried out a number of case studies in which we explored the triggers for market entry and the strategies adopted by the entrants. We also received information in response to written questionnaires and had a number of hearings with Mid-Sized and Small Operators. The following commentary is based on this range of evidence:

(a) In two case studies, Cornwall and north and west Norfolk, operators told us that the large-scale deregistration of rural services by incumbent operators following the deregulation and privatization of local bus services in the 1980s had provided entry opportunities to Small Operators. In both cases, the deregistered services had been put out to tender, initially entry had been of a small scale and the growth of the Small Operators had been gradual. We found that companies that had grown in this way (in particular, Western Greyhound, Thames Travel, Centrebus and Norfolk Green) had generally tended to focus on developing tendered routes, including by introducing commercial elements to them, and that overlaps between their services and those of competitors tended to be incidental, rather than actively pursued. They have, however, launched some commercial services, where they could identify gaps in the offerings of the established operators, and we have seen evidence that in some cases this type of entry has put significant pressure on the existing operator (eg Norfolk Green’s entry into King’s Lynn; Centrebus’s activities in Leicester). The evidence, however, also suggests that head-to-head competition with other operators remains at the margin of their operations. One of these operators, Thames Travel, emphasized that it sought small profitable opportunities and would seek to differentiate its service from the existing operator, for example by operating a quicker or more direct route.

(b) Similarly, a number of Small Operators told us that they had launched commercial services to use resources dedicated to tendered services at other times of the day. This type of expansion appears to be opportunistic and we have not received evidence from any of these operators that there had been any expansion in the provision of commercial services beyond the route which they had launched using the resources dedicated to the tendered service that they had won.

(c) We came across only one example of a Mid-Sized Operator which had considered using tendered services as a springboard for large-scale, rapid de novo entry into commercial service provision: Rotala originally planned to enter the Worcester area in 2009 with a fleet of 44 buses (22 of which were allocated to tenders) and to compete with FirstGroup on all the key urban routes. Although it won several tenders, opened a depot and launched one commercial service in competition with FirstGroup, its entry strategy, which in total involved a fleet of 32 vehicles, largely failed for a number of reasons, which are detailed in Appendix 6.4—Worcester.

(d) A number of Small Operators also told us that they had launched commercial services to replace commercial services which had been withdrawn, usually (but not always) by larger operators. Others identified a niche opportunity, eg services

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56 For example, Aston’s Coaches in Worcester, Bakerbus in Stoke on Trent, [X], [X], [X], Compass Travel, [X], [X].
57 For example: [X], Olympic Mini Coaches, Thames Travel, Shuttle Buses, [X], Dart Pleasure Craft Ltd-Riverlink, [X], [X], Rossendale Transport, [X].
aimed at students, night services, off-peak shopping services. The evidence suggests that such services do not tend to be in head-to-head competition with existing operators.

(e) Some Small Operators have also launched commercial services in head-to-head competition with larger operators where they perceived a gap, usually in terms of service quality or prices. There is evidence that some of these operators largely mirror the route of the pre-existing services (eg in Birmingham, Edwards Coaches in Cardiff, Premiere Travel in Nottingham), sometimes seeking to schedule their new service in front of the existing operator’s service. Others, however, seek to differentiate their service (eg Norfolk Green, Thames Travel, Speedwellbus, and some operators target specific customer segments (eg Yourbus in Nottingham).

(f) None of the Municipal Operators from which we received evidence has expanded beyond its usual area of operation. Expansion of services has typically been in response to customer or stakeholder (LTA, councillor) feedback, new housing or commercial developments or growth in passenger numbers.

**Responses to entry**

**Introduction**

6.105 In this section, we examine in detail evidence relating to the competitive behaviours of both entrant and incumbent following entry with the view to answering the following questions:

(a) How do incumbent operators respond to entry?

(b) To what extent does the period of competition following entry result in the exit of one of the two operators?

(c) To what extent are the tactics adopted by operators the direct cause of the exit of one of the operators?

6.106 Again, additional information that is of relevance to our consideration of operators’ responses to entry is set out in Section 8 of this report. This evidence suggests that operators’ responses have, in some situations, taken a form that had the objective of reinforcing market segregation. As such, the evidence set out below should be read in parallel with the discussion of retaliation in paragraphs 8.191 to 8.198.

6.107 In the bus industry, there have been examples of competitive practices which have been perceived as being vigorous or aggressive beyond the nature of competition which is observed in most industries. This is illustrated by the number of allegations of predation received by the OFT between 2001 and 2009: a total of 50 allegations of predation were made against other local bus operators, of which 37 related to the behaviour of one of the Large Operators. The OFT explained that it received around

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58 For example, Dodds of Troon, Countryliner, Suffolk County Council Travel Service, The Green Bus, Regal Busways.
59 For example, Edwards Coaches’ entry against Veolia (see Appendix 6.4—Cardiff); Norfolk Green’s entry against FirstGroup in King’s Lynn (see Appendix 6.4—North and west Norfolk); Premiere Bus and Yourbus entries in Nottingham (see Appendix 6.4—Nottingham), Speedwellbus’s entry against FirstGroup between Glossop and Manchester, Ensign Bus, Little Jim (launched services following a perceived gap in Arriva’s service quality) and Speedwellbus’s entry against FirstGroup between Glossop and Manchester.
60 As recorded by Arriva’s internal papers: adopted such strategies in the in 2009 and also scheduled its services 5 minutes in front of Arriva’s services on the route in 2008.
61 The OFT received other complaints but these were on issues such as fare increases, reduction of service frequency, advice on transport scheme, allegation of price fixing of fares.
four complaints about local bus operations per year, and that although in absolute terms the number was small, it was a lot higher than in other industries. The OFT carried out a full investigation in two cases, and made one infringement decision (Cardiff Bus) and one non-infringement decision (First Edinburgh/Lothian). In addition, an application by Chester City Council/CCT against Arriva was brought in front of the High Court under Chapter II of the 1998 Act and dismissed in 2007. Appendix 6.6, paragraphs 3 to 11, briefly set out the facts of the three cases.

6.108 According to one academic study,62 between 1986 and 1990 the OFT received ‘247 complaints about anti-competitive behaviour in the local bus industry’. However, it is not clear whether this refers only to allegations of predation or to allegations of other conduct (see the footnote to paragraph 6.107), and hence it is difficult to judge whether these figures are comparable with those presented in paragraph 6.107 above.

6.109 The Traffic Commissioners have also over the years received allegations of unfair competition, but not all cases are investigated and there is no system to monitor ‘fair competition’.63 Examples of such allegations are set out in Appendix 6.6, paragraphs 17 to 25. The Senior Traffic Commissioner told us that there had been two cases in his area in the previous year and he doubted that there were more than 20 in the whole of England and Wales. He added that while he was aware of many reported competition issues such as ‘bus wars’ and predation, the Traffic Commissioners may not be in a position to act. The Traffic Commissioner for the West Midlands and Wales mentioned three recent complaints relating to unfair practices in the West Midlands, but highlighted the lack of expertise Traffic Commissioners and VOSA had in relation to competition issues. []

**Submissions**

6.110 A number of local authorities told us that the nature of competition following entry was unstable. For example, Caerphilly County Council stated that ‘the pattern was generally competition, followed by consolidation (acquisition/demise of weakest operators) and ultimately a reduction in service levels, as victorious operators were left with depleted reserves and were unable to invest to maintain or grow the market’. It considered that head-to-head competition resulted in services which were ‘low in quality, sometimes verging on dangerous’. These views were largely echoed by Reading Borough Council and Wiltshire County Council. It was also argued that the reason for this outcome was that there was insufficient demand on many routes to support competition: one Small Operator ([]), for example, told us that:

if a competitor were to enter the market and compete on a particular route, the increased frequency of operation and extra capacity is unlikely to increase the overall number of passengers travelling by more than a few percentage points. Ultimately the new entrant will be competing for market share of an existing number of passengers. The original revenues will have to be shared between the competitors and if there is price competition to attract passengers those revenues may well be reduced. In these circumstances it is unlikely that either competitor will receive enough revenue to generate a profit or for that matter cover their costs. These competitive practices are only available to the large operator who can mitigate their losses by higher fares being charged elsewhere in the country.

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62 Source: *The local bus market, a case study of regulatory change*, Peter Mackie, John Preston, 1996.
63 Some of the allegations received by Traffic Commissioners may also have been received by the OFT.
6.111 In the course of our inquiry, a number of Small Operators complained about the practices of other operators, normally in response to entry, such as:

(a) the increase in the number of buses allocated to the competed route and frequency increases following entry;

(b) fare discounts available only on the competed routes and which were cancelled following the exit of the entrant; and

(c) various on-the-road practices, such as the blocking of stands,64 leapfrogging,65 and use of inspectors who managed the flow of buses, allegedly to maximize revenue abstraction from the competing service.

6.112 In total, we received 27 specific allegations of inappropriate conduct by incumbent operators (see Appendix 6.6, Table 1). In addition, two Small Operators (\(\star\)) both ceased operating during our inquiry and blamed their failure on the alleged exclusionary actions of one of the Large Operators (\(\star\)). One local authority, SPT, also relayed what it perceived to be exclusionary conduct by one of the Large Operators against another operator. We note that a number of submissions included allegations of stand blocking and ‘aggressive’ on-the-road behaviours (see Appendix 6.6, paragraphs 14 to 25). We sought to investigate some of these allegations in the context of case studies, but found that within the remit of our inquiry, it was difficult to establish the accuracy of the facts reported to us. These difficulties are illustrated by the account of the evidence we received in relation to competition between Veolia and Edwards Coaches. This is set out in Appendix 6.4—Cardiff, paragraphs 90 to 105. We asked operators for their views on what competitive behaviour would be unacceptable by ordinary standards (ie ‘unfair’), and found that the operators themselves had difficulties establishing where the boundaries lay (see Appendix 6.6, paragraphs 26 to 31).

6.113 The Association of Local Bus Company Managers (ALBUM) told us that the reaction of a PLC to an independent competing in its area was not entirely predictable. ALBUM did not believe that the behaviour of the PLCs was consistent, and their behaviour varied across their respective operating companies. It said that the majority of routes did not have the passenger numbers to support more than one operator. A medium-sized town of between 40,000 and 50,000 people would provide just enough profit for one operator. If another operator entered the market, and even if there was a large switch from car to bus, ALBUM believed that there would not be enough revenue to support both companies. It told us that \(\star\). ALBUM believed that an operator’s behaviour became questionable when it adopted behaviour contrary to how it would operate if head-to-head competition existed.

6.114 ALBUM told us about one case, where a Small Operator had competed against a larger operator over a number of years. On a specific route, the larger operator decided to reduce frequencies and triple fares, and the Small Operator saw a gap in the market that it set out to exploit. The Small Operator offered a more direct service and ran low-floor buses on the route and the larger operator responded with a combination of increased frequencies and lower fares. The Small Operator would not have complained about a legitimate, competitive response, but the larger operator now ran a loss-making service. The Small Operator believed that the reaction went from being robust and fair to robust and unreasonable and that the aim of the larger

64 When an operator positions its buses at bus stations or bus stops in order to prevent access to stands or stops by other operators, for example by leaving a bus parked waiting at bus stops or stands.
65 When one operator runs its bus service directly ahead of another operator’s service on the same route, in order to collect the passengers who are waiting for the other operator’s bus service.
operator was to put the smaller rival out of business. The larger operators could also cross-subsidize their different operating companies and switch resources between them when necessary.

6.115 ALBUM said that bus markets were locally focused and the PLCs' local operations across the UK were run by local managers. Even if tightly controlled from the centre, the manner in which the local companies operated was strongly influenced by the personalities and characteristics of the local management. A good manager could be replaced by a poor manager overnight and the company could change from an excellent company to a very bad one. This was not only the case among the Large Operators, and allegations of poor practice against independent companies had been made when a good manager was replaced by one who was not so effective.

6.116 Thames Travel commented that larger operators tended to react to smaller operators that entered on to their routes by trying to drive them out of business, rather than trying to understand why there had been an opportunity for entry by the smaller operator and improving their own business elsewhere. Thames Travel thought it was perfectly acceptable for a larger operator to prevent entry by smaller ones by running a good bus service and growing the market, but this was not what it thought happened in practice. Larger operators could try to prevent entry by smaller operators in a number of ways. Some larger operators had a reputation in the industry for being very aggressive and driving small operators out of business. The reputation had arisen from events that had taken place in the past, including in recent years. Preventing smaller operators from joining multi-operator schemes was another tactic that had been used.

6.117 The Large Operators told us that on-the-road behaviour designed to weaken rivals had been more prevalent in the past and had now largely disappeared. Stagecoach and FirstGroup emphasized that there was a distinction between robust competition and exclusionary conduct and that they had compliance procedures in place. Arriva emphasized that the CC should draw a distinction between, on the one hand, a reaction to entry by a competing bus operator on to a particular route or into a particular local area which adversely affected competition in breach of competition law and, on the other hand, a reaction which amounted to a wholly legitimate response to competition. Arriva had compliance procedures in place. In response to a question regarding whether Arriva obtained legal advice when making changes to high-frequency services (entry, price etc), Arriva said ‘it tried to avoid “bus wars”. It did take legal advice but it was not always easy to judge when robust competition might become too aggressive’.

6.118 Arriva told us that in response to entry, it would focus on ensuring outstanding punctuality and driver behaviour and that it was down to the local management to react appropriately to competition. Other responses that Arriva might adopt in response to entry included putting additional vehicles in service and competing on price. Arriva said that it tried to avoid ‘bus wars’. It told us that competition on one route could be successful in the long run, but indicated that new entrants might use this as an opportunity to build on.

6.119 FirstGroup told us that the bus market was a very competitive market and that at times competitive interactions could be intense as rivals sought competitive advantage. It told us that ‘if it were operating on a route and a new operator wanted to come in, it would respond robustly, but it did not play a tit-for-tat game of changing its pattern of service’. It gave an example where it had not changed its timetable when a new service was registered with a 2-minute headway in front of its existing service.
As a policy matter, headrunning\textsuperscript{66} was not something that it did because in its view customers did not like frequent changes to timetables,\textsuperscript{67} and where operationally possible it would not change its frequencies in response to entry to operate just ahead of the entrant, but would attempt to split the headway so that it was more even. FirstGroup told us that its response to entry would depend on individual circumstances. It could be promotional in character or it could be some other proposition that recognized a new category of demand. It told us that it might implement temporary changes in pricing policy, which could stimulate the market but were not always removed if a competitor withdrew. In some areas it had responded to the lower prices offered by the entrant by introducing new fare offers, in particular around its period tickets. It had also responded to entry by increasing the frequency of its services and this had resulted in higher levels of frequency in some parts of its network than might otherwise have been the case. In some cases, it had improved the quality of services allocated to competitive routes. It also told us that when it took actions, it did not set out expecting them to be temporary or short term. At times, FirstGroup might take no action because it considered that an entrant had misjudged the level of demand, acknowledging that sometimes there might not be a level of demand that could sustain two operators on a particular route. FirstGroup considered that the worry about exclusionary conduct was a myth, particularly as it had seen quite a number of entries against its services, and most of those entries were still in place. It told us that ‘rivals have not actually been significantly excluded from a local area as a result of any “fear”—thriving smaller operators and numerous entry and expansion events show that [an] exclusionary theory is not borne out by the evidence’.

6.120 Go-Ahead told us that its intention was to ensure that it operated a very good-quality and comprehensive network, so that the opportunities for gaps in the market were small. It said that it was possible for a situation to arise where intensified competition would produce short-term customer benefits, but if that market was not able to sustain the frequency of or investment in the service over a longer period of time, the level of competition might tail off. Generally Go-Ahead’s view was that it needed the right to compete, and as long as income covered direct costs, then most operators in the industry would regard this as fair competition.

6.121 National Express told us that generally competitors tended to go on to routes on which there was enough patronage to sustain two operators. Head-to-head competition did spur an operator to keep its service running well and to offer improvements. Most competitors on routes on which National Express operated tended to offer lower prices, but National Express stuck to its network pricing model. Fare cuts and promotions in response to competition were very unusual for National Express. The levels of service it offered were intended to be permanent and frequency would not be changed in the short term. In response to entry, National Express would run its advertised service to the best of its ability. In its view, entry on a route was likely to be unsuccessful because of the economics of the industry which forced a new entrant to increase capacity by at least 50 per cent to be successful (ie to offer a sufficiently high frequency to be competitive), which in turn would result in an unstable outcome, as there would be too many buses relative to the size of the available demand.

6.122 Stagecoach often observed entry to see how seriously to take it.\textsuperscript{68} Similarly it would not rule out entirely a temporary and unsustainable increase in frequency as a reaction to a competitor. However, it would be rare, and Stagecoach would be more

\textsuperscript{66} When one operator runs its bus service shortly ahead of another operator’s service on the same route, in order to collect the passengers who are waiting for the other operator’s bus service.

\textsuperscript{67} Paragraph 4.7 of FirstGroup’s response to the Updated Issues Statement.
likely to increase frequency where it thought it could be sustainable and it could grow the business. Stagecoach commented that some Small Operators managed to develop their business sustainably and to remain in the market. Entrants could even displace the original established operator. Some other Small Operators entered the market and disappeared quickly. If entry was successful, a new equilibrium would evolve. Stagecoach said that in a head-to-head competition situation, both operators would take various short-term tactical decisions on what to do stage by stage, but in the long term, the competition would eventually end in a new equilibrium. In Stagecoach’s view, if actual competition came about, arguably either the incumbent or the competitor had misjudged the market. Many small competitors failed through their own poor management. If a bus operator chose to enter into head-to-head competition, it needed to measure the scale of what it would do. Stagecoach told us that every time it increased the frequency on a route there was a step change in costs, while the revenue took time to build up. In the bus industry, this was a reason for an entrant to come in at a relatively small scale and build up its operations gradually. A bus operator was more likely to achieve substantial long-term scale by entering in a small way than by entering in a big way. Unlike other industries, capacity in the bus industry was flexible and need not be fixed at the point of entry.

6.123 In order to understand this issue further, we asked a number of operators how they had responded to entry in recent years. We carried out case studies of areas where there had been entry or expansion in recent years, conducted hearings with a number of operators and examined relevant internal papers. This evidence is presented in the following sections.

Type of entry or expansion to which operators have responded and outcome

6.124 We asked Large and Mid-Sized Operators for all occasions, in the five years to spring 2010, where they responded to competition by increasing capacity on a route (by switching capacity across routes in the same area and/or by increasing frequency on a route by expanding capacity in the area). We have information on the type of competition against which operators responded on 183 of the occasions. Of these, 117 were simply reported as a response to ‘head to head competition’. On 66 occasions operators responded to new services launched by competitors or increases in competitors’ frequencies, as shown in Table 6.2.

<table>
<thead>
<tr>
<th>Type of competition</th>
<th>Number of times the behaviour was reported</th>
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<tbody>
<tr>
<td>Competitor…</td>
<td></td>
</tr>
<tr>
<td>Competed head-to-head</td>
<td>117</td>
</tr>
<tr>
<td>Launched a new service head-to-head</td>
<td>32</td>
</tr>
<tr>
<td>Increased frequency</td>
<td>24</td>
</tr>
<tr>
<td>Revised timetable to operate in front of rival’s service</td>
<td>3</td>
</tr>
<tr>
<td>Won new tendered contracts</td>
<td>2</td>
</tr>
<tr>
<td>Increased frequency and reduced fares</td>
<td>1</td>
</tr>
<tr>
<td>Reduced fares</td>
<td>1</td>
</tr>
<tr>
<td>Entered into a new area</td>
<td>1</td>
</tr>
<tr>
<td>Other</td>
<td>1</td>
</tr>
<tr>
<td>Unknown</td>
<td>1</td>
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</tbody>
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Source: CC analysis of operators’ responses.

*Operators only reported the behaviour of entrants to which they responded by switching capacity across routes in the same area and/or by increasing frequency on a route by expanding capacity in the area.

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Source: CC analysis of operators’ responses.

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68 Stagecoach itself has adopted such an approach in north Devon (see Appendix 6.4—North Devon, paragraphs 26–33).
6.125 On 48 occasions, operators told us what the ultimate outcome of the competition had been, see Table 6.3 (for many operators, we did not have information on this issue). On around half (25) of these occasions, the total increase in capacity (across both entrant and incumbent) remained in place. On around 40 per cent of occasions (18), at least one of the operators retrenched, of which 11 resulted in the exit of one of the operators. In seven cases, the exiting operator was the incumbent; in three it was the entrant; and in one, both exited the route.

TABLE 6.3 Outcome of competitive responses

<table>
<thead>
<tr>
<th>Occasions where each outcome occurred</th>
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<tr>
<td>Increase in capacity remains</td>
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<tr>
<td>Retrenchment by at least one of the operators</td>
</tr>
<tr>
<td>—of which involved exit by at least one operator</td>
</tr>
<tr>
<td>Further competitive actions by at least one operator</td>
</tr>
</tbody>
</table>

Source: CC analysis of Large and Mid-Sized Operators’ responses.

6.126 The interpretation of this evidence is subject to three limitations: the sample size is small; most of the information (ie 40 of the 48 instances listed in Table 6.3 above) was provided by one particular operator; and because the data was provided at a given point in time, the outcome described, particularly where the increase in capacity remained, may not have been the ultimate, long-term outcome.

6.127 We have been made aware of three methods by which a sustainable competitive outcome can take place: it can be the result of the intervention of the local authorities, which may seek to facilitate the signing of a voluntary partnership agreement (VPA) that regulates service frequencies (eg as in Chester in 2010 following a period of intense competition between Arriva and FirstGroup, this partnership agreement is discussed in more detail in Appendix 12.2); or the result of intervention by Traffic Commissioners (eg in relation to route 192 in Manchester); or the result of the operators themselves independently retrenching. Operators did not explain to us how this latter type of retrenchment might occur but the Oxford case study and to a lesser extent the King’s Lynn case study (see Appendix 6.4) suggest that this can occur if after a period of time both operators independently reach the view that they have a similar competitive strength in the local market and are both unlikely to exit. In the case of Oxford, retrenchment took place after the two operators were acquired by major groups.

Responses to entry

6.128 We asked operators about the nature of competition following entry. The data provided to us by the operators has been inconsistent and it is therefore difficult to draw conclusions from responses to our written questionnaires alone. Taking this into account, we present below a qualitative assessment of the responses to entry of certain operators and illustrate the range of responses that have been adopted by drawing upon a variety of sources of evidence including case studies we carried out, our review of internal documents and various examples provided to us by operators during our evidence-gathering process.

6.129 As part of our written questionnaire, we also asked the Large Operators and the Mid-Sized Non-Municipal Operators to provide evidence on the most substantial fare changes they had implemented in 2009. This evidence shows that in several cases head-to-head competition was a reason behind operators’ substantial fare cuts, and was the only reason supported by associated internal documents. It is not always
clear from operators’ responses to the written questionnaire whether these substantial cuts in fares were in response to entry or expansion, or whether they were part of ongoing head-to-head competition between operators.

Responses of the Large Operators

6.130 Arriva told us that it faced head-to-head competition on 50 per cent of the mileage it operated. The information it provided in response to our data requests is incomplete, but we are aware of 40 occasions when it has responded to entry by increasing the frequency of its service or launching a new service, but have limited information on the nature of its other responses to entry. One Small Operator ([...]) told us that following its entry on a route served by Arriva, Arriva had introduced promotional fares with a reduction of up to 60 per cent. This had been supported with marketing activities.

6.131 In the Tyneside case study, we explored the response of Arriva to two entry events. When Go-Ahead entered with a more direct and lower-cost service than the existing Arriva service on the Ashington–Newcastle route, Arriva responded by introducing a new service using a different brand, older buses and matching Go-Ahead’s timetable. Go-Ahead withdrew after a few months but Arriva continued to operate the service it had launched following Go-Ahead’s entry. On another route, where Go-Ahead’s service followed a different route from Arriva’s but competed between the two main centres on the route, Arriva responded by introducing new vehicles, changing its timetable, carrying out a major promotional campaign, launching a new express service and introducing some promotional fares. Go-Ahead, however, told us that Arriva’s actions had little impact on Go-Ahead by comparison with changes in demand driven by local developments. We note that in late 2009, Go-Ahead and Arriva sold to each other the depots from which they had operated competing services. The transaction was cleared by the OFT (see Appendix 6.4—Tyneside, paragraphs 109 and 110, and 116 to 129, and Appendix 8.5, paragraphs 29 to 38, in the context of geographic market segregation).

6.132 Our review of the monthly operations reports prepared by Arriva’s operating companies shows that Arriva monitors entry in competition with its services and generally assesses whether revenue is abstracted from its services before considering what actions, if any, to take.69 Although the decisions made are not always recorded, the evidence shows that when it has responded to entry, Arriva has adopted a variety of approaches, including the following, which were sometimes adopted in combination:

(a) improvements in the quality of the fleet, including new vehicles, refurbishment, repainting and branding of vehicles;

(b) retaliation on other routes within the operating company’s area of operation;70

(c) increases in frequencies;

(d) proactive management of buses in order to maintain the reliability of services;

(e) making timetables more attractive to customers;71

(f) marketing and promotional activities, including fare promotions;

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69 An example of this is the assessment that [...] made of [...] entry against it in P4 2008: ‘their superior professionalism will undoubtedly cause revenue abstraction in comparison to the slipshot manner the [...] group of companies were operated.’

70 Arriva told us that some of these were examples of intense short-term head-to-head competition.

71 Arriva told us that it constantly matched timetables to demand to make services more attractive to customers.
(g) on one occasion, a decrease in frequency;\textsuperscript{72} and

(h) the proactive management of customers, with the use of ‘a Forecourt Ambassador, equipped with a hand-held ticketing facility to offer the ability to queue bust and give a competitive advantage’ or the use of ‘customer services supervisors’, the role of which is unclear but which had the effect of ‘low patronage levels’ on the competitor’s services.\textsuperscript{73}

6.133 The data\textsuperscript{74} provided by FirstGroup in response to our questionnaire suggests that it has responded to entry in [\texttimes{X}] cases out of the [\texttimes{X}] entry events in the five years to spring 2010 against its services that it reported:

(a) [\texttimes{X}] of its responses involved just a frequency increase, with a further [\texttimes{X}] occasions involving a mixture of frequency increase and/or fare changes and/or bus allocation response;

(b) [\texttimes{X}] responses involved just a fare cut, with a further [\texttimes{X}] occasions involving a mixture of fare cuts and/or frequency and/or bus allocation responses; and

(c) a variety of other responses were also listed in FirstGroup’s internal documents, including ensuring punctuality and even headways, retiming of routes, developing the network of services, and introducing dedicated rotas of drivers to build customer relationships, but these were all less common responses than reduced price and/or increased frequencies, and/or the allocation of better buses.

6.134 Internal documents from FirstGroup show that six of its 18 most substantial fare cuts it identified in response to our written questionnaire were in competition with operators in King’s Lynn, Weston-super-Mare and Worcester, which were areas in which FirstGroup faced entry and expansion against its services (see Appendix 6.1, paragraph 34). We explored FirstGroup’s responses to entry in detail in a number of case studies (see Appendix 6.4—North and west Norfolk, North Devon, Cornwall and Worcester) and through a review of its operating companies’ internal documents. We summarize in the following paragraphs the themes that emerged from our review.

6.135 FirstGroup monitors and keeps a record of all the registrations of local bus services by any competitor in all its areas of operation. Internal documents suggest that in most cases it first monitors the impact of the entrant on its services’ revenue before acting. However, in other cases (eg [\texttimes{X}]), it prepares ‘[\texttimes{X}’] ahead of the entry ([\texttimes{X}]).

6.136 FirstGroup’s responses to entry at the route level do not appear to be markedly different, whether it competes with larger or smaller operators: for example, FirstGroup’s internal documents show that it reduced prices in some form in response to entry or expansion by Stagecoach in north Glasgow, Cumbernauld, Sheffield and Northampton, Arriva in Chester and Leicester, Rotala in Bath/Bristol, Redditch and Worcester, Lothian Buses, Veolia in South Wales, UniLink, Meridian Bus, Whittles, Webberbus, ACL, South Wales Transport and K Line. The internal documents also show that FirstGroup increased the frequency of its services in head-to-head competition with Stagecoach in south Glasgow, Taunton and Sheffield, Arriva in Chester

\textsuperscript{72} This is the only example of a decrease in frequency in response to entry documented in operating company papers. However, Arriva provided other examples of responses to competition that involved decreases in frequency or capacity (see Table 6.3 and paragraph 8.64).

\textsuperscript{73} Arriva told us that both of these actions were in relation to public transport interchanges on airport premises and were specific to those premises. Arriva told us that these were atypical to ordinary local bus services.

\textsuperscript{74} These figures use the same underlying data as that reported in Appendix 6.5, paragraphs 25–28. However, in this section the figures refer to entry events, whereas in Appendix 6.5 the figures refer to the number of routes that experienced entry. An entry event can include entry on several routes and hence while the figures in this section do not correspond to those presented in Appendix 6.5, they are based on a consistent data source.
and Leicester, Rotala between Bromsgrove and Birmingham and in Redditch, SLT, Baker Bus, TJ Walsh, Webberbus, ACL and South Wales Transport. We have seen evidence of muted responses to entry both by Large Operators (eg its response to Stagecoach in north Devon; see Appendix 6.4—North Devon, paragraph 34) and by Small Operators.\footnote{Discussed further in Appendix 6.4—North Devon, paragraph 34.} We have also heard of cases where FirstGroup has not responded to entry at all, having judged that the new service was unlikely to impact on the performance of its own service.\footnote{Discussed further in Appendix 6.4—North Devon, paragraph 34.} Other aspects of FirstGroup’s responses to entry mentioned in its internal papers include: improving the reliability of its services (for example, in competition with Veolia in South Wales and against Sureline in Hampshire); allocating dedicated rotas of drivers to build customer loyalty (for example, against Wessex Connect in Bath); utilizing quality vehicles on competitive routes (for example, in competition with Faresaver in Bath and in competition with ACL in Weston-super-Mare); and increasing marketing activity (for example, in competition with Webberbus in Somerset).

\subsection*{6.137} FirstGroup’s internal documents also contain evidence of intense and/or large-scale responses to entry—in Chester, for example, following FirstGroup’s acquisition of Chester City Transport in June 2007, shortly after Chester City Council’s claim of predatory conduct by Arriva was dismissed by the High Court (see paragraph 6.84). FirstGroup’s internal documents suggest that Arriva significantly expanded its services and increased the level of competition with FirstGroup following its acquisition of CCT. This was followed by several months of intense competition, which was brought to an end by the implementation of a VPA. Competition between the two companies concerned various aspects of price and service provision (including fare promotions, different ticket types, network improvements,\footnote{Discussed further in Appendix 6.1, paragraph 73.} new services and changes to timetables) and was supported by a substantial amount of marketing targeted specifically at the local community.\footnote{Additional evidence relating to the nature of competition between Arriva and FirstGroup in Cheshire and the North-West is set out in Appendix 8.6.} An example of a strong response to entry by a Small Operator is FirstGroup’s very deep fare discounts combined with a doubling of frequency on one route, and multiple service launches across King’s Lynn in competition with Norfolk Green in 2009 (see Appendix 6.4—North and west Norfolk, paragraphs 49 and 50). Another example is FirstGroup’s stated approach to competition on one particular route in Swansea, as reported in one of its board papers: ‘First’s 81 service (targeted at Swansea College/Institute and in direct competition with Veolia)—[\footnote{Additional evidence relating to the nature of competition between Arriva and FirstGroup in Cheshire and the North-West is set out in Appendix 8.6.}].\footnote{Additional evidence relating to the nature of competition between Arriva and FirstGroup in Cheshire and the North-West is set out in Appendix 8.6.}"

\subsection*{6.138} Although FirstGroup told us that it did not take action on one route or in one area in order to ‘punish’ a rival in another area, its internal documents suggest that on some occasions there has been a strategic element to its responses to competition from other Large Operators, although we note that not all the strategic options it considered were implemented. We set out these examples below; however, a fuller discussion of strategic actions of this type is given in paragraphs 8.191 to 8.198:

(a) In response to competition with Stagecoach in Sheffield, FirstGroup’s local operation considered ‘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 were simply part of the ‘pitch’ by the local company to the UK Bus Board for greater resources and recorded operating company suggestions on how to react to the threat of Stagecoach and the decline in revenues that it had experienced. It said that the suggestions had not been acted upon other than to put in place some limited price changes in Sheffield, and no other actions, in particular none in other areas, were taken as part of a wider strategy.

(b) In Glasgow, FirstGroup was concerned that ‘[X]’, Stagecoach [X]. FirstGroup focused on competing hard in Cumbernauld [X]. Furthermore, 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 note, however, that Fife Council’s understanding of the situation is consistent with FirstGroup’s internal report:

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 Devon, FirstGroup considered (and rejected) the option of responding to Stagecoach’s entry in north Devon [X] against Stagecoach in Exeter, and later also considered responding to increased competition by Stagecoach in north Devon, by [X] (but again rejected this option) (see Appendix 6.4—North Devon, paragraphs 19 to 21).

(d) Another document showed that FirstGroup responded to increased competition from Arriva in Chester by registering a competitive service in the Wirral against Arriva. FirstGroup later withdrew this service, hoping that it would in turn ‘encourage our competitor in Chester [Arriva] to withdraw from Blacon’. 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’. This, and other examples of the nature of

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79 We noted that pitch for additional resources in the 13 August 2007 UK board minutes did not appear to mention the proposed retaliation against Stagecoach on other routes.

80 A paper presented to FirstGroup’s UK Bus Board on 10 October 2007 discusses 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 [X]."
competition between Arriva and FirstGroup in Chester, is discussed in further
detail in Appendix 8.6.

6.139 Go-Ahead has responded to entry by increasing the frequency of its service or
launching a new service on seven occasions:

(a) Its Go North East division has responded to entry by both Stagecoach and Arriva.
On one occasion it increased the capacity of its buses, and on the other it
increased the frequency of its service. Its Metrobus subsidiary told us that it had
made no changes to services in response to competition in the last five years and
reported three occasions of entry by Small Operators, to which it did not respond,
even though on two of them the entrant largely duplicated its services. On both of
these occasions, the entrant subsequently exited the route. Further evidence on
the nature of competition in the North-East is provided in Appendix 8.5.

(b) Its Plymouth division responded to the entry of FirstGroup against its services in
October 2009 (see paragraph 6.87) by increasing the frequency of two services
and launching a new service in competition with a FirstGroup service in another
area of Plymouth.

(c) Go-Ahead told us that its Brighton and Hove subsidiary did not alter its routes,
pricing or behaviour in response to the entry of the Big Lemon in 2007, but
increased the frequency of its service to respond to general market growth. We
understand that subsequently, Go-Ahead has reduced its fares in competition
with The Big Lemon.81

(d) It is unclear how its Go South Coast subsidiary has responded to entry, but the
two entrants that it has mentioned to us are still operating in competition with its
services.

(e) Oxford Bus Company’s responses to entry are described in the Oxford case
study (see Appendix 6.4—Oxford, paragraphs 65 and 68). Following the entry of
a Small Operator, RH Transport, on two commercial routes in competition with
Go-Ahead’s local operation, Oxford City Council told us that Go-Ahead increased
the frequency of its service on one of the routes. RH Transport withdrew its ser-
VICES after a few months, but the evidence received suggests that this may have
been caused by the lack of attractiveness of its service. Following RH Transport’s
exit, Go-Ahead continued to operate with the increased frequency. Another, albeit
older, example of entry was Stagecoach’s new service between Abingdon and
withdrawal, Go-Ahead increased the number of buses on the route and frequency
[×].

6.140 In response to our questionnaire, Stagecoach identified83 118 occurrences of entry
against its services. It told us that on 88 occasions, it did not respond to the entry. On
19 occasions, its response involved a change to its service provision, including on
some occasions the launch of a new or duplicate service and/or an increase in
service frequency. On five occasions, its response was entirely fare-based. On three
occasions, its response involved a change in fares combined with changes to service

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81 We understand that the weekly ticket on services 23/25 is currently £8 if purchased on the bus, compared with £14 if pur-
chased online or £16.50 if purchased from shops.

82 [×]

83 As with the data provided by FirstGroup, these figures use the same underlying data as that reported in Appendix 6.5,
paragraphs 11–13. However, in this section the figures refer to entry events, whereas in Appendix 6.5 the figures refer to the
number of routes that experienced entry. An entry event can include entry on several routes and hence while the figures in this
section do not correspond to those presented in Appendix 6.5, they are based on a consistent data source.
frequency or the launch of a new service. On three occasions, it withdrew its service following the entry. Below are examples of Stagecoach’s responses to entry based on case studies and our review of their internal documents:

(a) In Barnsley, competition between Stagecoach and Tates Travel had developed since July 2009. Following its acquisition of Yorkshire Traction, Stagecoach carried out a review of the Barnsley network and rationalized a number of services, which prompted the entry of a Small Operator to fill the gap in service provision, which it had been made aware of by local residents and South Yorkshire PTE (SYPTE). Stagecoach told us that recognizing that aspects of its network reconfiguration had been misjudged and following an assessment of several options, it introduced a new, direct service in the same area to improve its network and to counteract the material effect of Tates Travel entry on its passenger and revenue numbers. The Stagecoach service was intended to be more direct and coordinated with Stagecoach’s existing services. Tates Travel perceived Stagecoach’s behaviour as predatory and wrote to us to this effect in March 2010. It also alleged that Stagecoach’s service had been timed 3 minutes in front of its own. Stagecoach refuted the allegation that its conduct was predatory, and provided internal documents that stated that it expected the new service to cover direct costs of operation, and told us that performance had been in line with those expectations. Stagecoach told us that its service had been timed to coordinate with its existing services and that its timing in relation to Tates Travel was coincidental. Stagecoach told us that Tates Travel had later retimed its service to operate in front of Stagecoach’s and Stagecoach had not responded. SYPTE told us that a small change to Tates Travel’s registration resolved issues raised by Tates Travel in relation to stand allocation at Barnsley Interchange, but that SYPTE’s policy in relation to stand allocation had, in its view, been complied with. Although Tates Travel told us that Stagecoach’s new service had had a significant impact on its revenue, its service was still in operation as of February 2011. We also note that Tates Travel launched a number of other services in competition with Stagecoach in Barnsley and that Stagecoach did not respond to these other entries.

(b) In Tyneside, Go-Ahead entered into competition with Stagecoach on the route between Metrocentre and Gateshead. [6.141]

National Express told us that around per cent of its mileage per cent of its patronage) was subject to competition, which it told us highlighted the impact of operators cherry-picking routes. National Express told us that there were many examples of competitors who had entered the market over the last five years. It also told us that some Small Operators had subsequently left the market because they had been unable to meet the maintenance requirements set out by VOSA and the Traffic Commissioners. National Express said that it had identified many instances of entry in the market but that tracking exit was more difficult, although it told us that it did not have information on commercial registrations in competition with its services in the five years to spring 2010. It said that it did not adjust fares at the individual flow/route level as it operated a network-wide fares policy (it told us that fares were set at the network level to reflect market conditions across the network). It believed that the best way to maintain competition, and its strategy in response to it, was first to ensure that the service was reliable and that the full published timetable was actually being achieved, with high levels of punctuality. National Express said that this activity was coordinated by local route managers (route inspectors) and, if necessary, on ‘frequent’ routes spare off-peak vehicles could be deployed to ensure that the registered timetable was operated. We explored National Express’s competitive behaviour in the Birmingham case study and found that in general National Express does not respond to competition (see Appendix 6.4—Birmingham and Black Country,
We also received evidence that it allocated better buses on routes where it competed with Rotala’s Diamond Bus subsidiary. Although we found evidence of one fare-based response to entry (see Appendix 6.4—Birmingham and Black Country, paragraph 40), this does not appear to be a common practice. One Small Operator also told us about National Express’s practice of allocating route inspectors and more buses to a competitive route, but it was not clear to us whether this could be viewed as a competitive tactic or, as suggested by National Express, a practice designed to improve the reliability of services.

**Responses of other operators to entry**

6.142 We received evidence on the responses to entry of other types of operators in the course of two case studies—Cardiff and Nottingham:

(a) In Cardiff, we sought to examine the entry of Edwards Coaches on a route previously served primarily by Veolia, but also by Stagecoach. There was no suggestion that Stagecoach had responded to Edwards Coaches’ entry. We understand that Veolia, on the other hand, responded by reducing its day and weekly fares by up to 42 per cent, although Veolia did not confirm that this had been the case. Both Veolia and Edwards Coaches made allegations about the other’s on-the-road behaviour, including headrunning, blocking access to stands and slowing down the operator’s buses, and operating free services prior to registration. Edwards Coaches told us that Veolia had doubled its frequency, but this fact was not confirmed by Veolia. The evidence we have seen suggests that the nature of competition on these routes was not sustainable. In this case, however, the accounts of events presented by the operators were markedly different and it was difficult to establish the facts, due to the lack of records that we could rely on. However, we obtained a file of evidence considered by the Traffic Commissioner for Wales and the West Midlands. It showed that the drivers of both operators had adopted aggressive on-the-road tactics (see Appendix 6.4—Cardiff, paragraphs 103 to 105).

(b) In Nottingham, two Small Operators, Premiere Travel and Yourbus, both launched services in competition with Trent Barton, and in the case of Yourbus, with NCT. We found that on one route, Trent Barton responded to Premiere Travel’s entry by introducing a weekly ticket, promotions for its smartcard and reduced smartcard off-peak single fares. Trent Barton’s fares had, however, remained higher than those of Premiere Travel. Trent Barton did not increase the frequency of its service. Allegations of stand blocking and other on-the-road tactics were relayed to us, but we were not able to verify their factual accuracy. By contrast, following the introduction of another service by Premiere Travel against Trent Barton, a sister company of Trent Barton, Midland General (both part of the Wellglade group), launched on the same route a ‘no-frills’ service offering very low fares. Premiere Travel perceived this response to be exclusionary. Wellglade advanced two rationales for its actions: in replicating Trent Barton’s offer at slightly lower fares and at a slightly lower quality, it was unlikely to grow the market significantly, but merely to redistribute it; and a case was made to test the ‘no-frills’ concept in the marketplace.

**Headrunning and leapfrogging**

6.143 We have seen little evidence that operators engage extensively in headrunning (changing services to run shortly ahead of a competitor’s services) and leapfrogging (where operators ‘race’ to try to overtake each other to be the first to arrive at the busiest bus stops). We have seen no evidence that leapfrogging tactics were
adopted by either operator in the north Devon case study. Arriva’s internal documents record a small number of instances of operators timing their services just in front of those of Arriva or of periods of constant timetable re-registrations. We found five instances in FirstGroup’s internal documents where another operator timed its arrivals just in front of those of FirstGroup (McKindless, Whittle’s, Baker Bus, Faresaver and Veolia), and FirstGroup’s documents do not suggest that it responded by retiming its services in front of those operators. FirstGroup’s documents recorded that it implemented ‘timetable changes’ following entry by Rotala, Arriva, Baker Bus and Veolia, but do not provide any more detail on what these changes involved (or even if these instances could be said to be ‘leapfrogging’ or ‘headrunning’) or whether these had any impacts on timing relative to the rivals’ services. There is some evidence that the competition between Stagecoach and Tates Travel involved some retiming of services at the beginning of the competitive interaction, but that both operators rapidly adopted stable timetables. In the course of our hearings with other operators, we received other reports of instances of operators timing buses just in front of one another’s services: from Speedwell in relation to FirstGroup; from Norfolk Green in relation to FirstGroup and Sanders Coaches; from Edwards Coaches in relation to Veolia; from Veolia in relation to [ ], Edwards Coaches, and Glamorgan Bus; [ ]; and from Western Greyhound in relation to FirstGroup. Worcestershire County Council also referred to Rotala and FirstGroup overtaking on a dedicated bus way in Redditch and jockeying to exit first from the bus station.

**Competition with other modes of transport**

6.144 In this section, we begin by summarizing the views of the Large Operators on the constraint from other modes of transport. We then look at the evidence from internal documents and from operators’ written questionnaire responses, in order to evaluate to what extent this supports operators’ views.

**Views of the Large Operators**

6.145 Arriva told us that outside London, bus use was declining because the real cost of driving a car had fallen while the real cost of using a bus had risen, and increasingly people took the car in preference to the bus. Arriva used market research to estimate that 65 per cent of its customers had access to alternative forms of transport, and noted that it faced competitive constraints from other modes of public and personal transport. Arriva noted that the constraint from modes other than the car (such as rail, bicycle and walking) varied from area to area. Arriva told us that in order to retain and win bus patronage and to reverse the decline in long-term demand for its bus operations, it focused on maintaining high-quality services and perceived value for money.84

6.146 FirstGroup told us that for any given journey a customer had a number of potential choices, most often a choice between a car and public transport, and that there was potential to attract passengers from other modes of transport—in particular, the private car. FirstGroup told us that its key focus was to attract car users to make greater use of the bus which depended on improving the punctuality and reliability of bus services, which it said were among the highest priority performance indicators for passengers. FirstGroup said that accordingly its local operating companies invested considerable management time and capital ensuring that they provided high-quality and efficient bus services.85 FirstGroup also noted that the ability to provide an effec-

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84 Arriva’s initial submission.
85 FirstGroup initial submission, paragraph 1.6.
tive alternative to the car depended in part on the provision of effective bus priority measures and other constraints imposed on bus usage by LTAs. FirstGroup told us that as well as a long-term constraint, the private car imposed a constraint on its short-term decisions, as, for example, it took into account car-park pricing when setting its day ticket fares.

6.147 Go-Ahead told us that each of the local areas in which it operated was subject to competitive pressure from other modes. Go-Ahead told us that bus operators competed with cars and that in towns like Oxford and Brighton, where the attitude of the city council was very anti-car, public transport use was encouraged and there was a constraint from cycling and walking for short-term trips. Go-Ahead told us, however, that while the constraint from other modes of transport on its business decisions was important, the threat of competition with other operators was absolutely key. It stated that in some areas it maintained evening services, even though they brought in little money, as the withdrawal of these services might lead passengers to travel by car instead.

6.148 National Express told us that car users (both passengers and drivers) represented a large and increasing pool of potential customers that could be encouraged to switch to bus, but that there was also the risk of bus passengers switching to cars if there was a change in the generalized journey cost of bus travel vis-à-vis car travel. National Express told us that it had taken various steps to make its services more competitive with the car, such as implementing an exact fares policy to speed up boardings as well as operating a simple fares structure, providing direct and frequent services and ensuring attractive access to bus stops and stations. National Express also told us that walking, cycling and taxis provided an alternative mode of transport for certain types of journeys and for certain passengers. Finally, it noted that overlapping rail/tram services competed with bus services on certain point-to-point flows, depending on the specific characteristics of that flow. It said that competition between different modes of transport occurred on the basis of a number of different parameters such as journey time, frequency, reliability, convenience and safety.

6.149 Stagecoach told us that its aim was to compete for a larger share of the growing local transport market by encouraging modal shift to the use of the bus over other modes, primarily the private car. It noted that this strategy involved looking at the longer-term impacts of its decisions. It told us that depending on local market characteristics, commercial bus services competed to varying degrees with walking, cycling, taxis, trams and local rail services. It said that in all cases, bus operators competed with the private car.

Evidence on competition with the car

6.150 The qualitative evidence suggests that the actions taken by operators to compete with the car are focused on the segmentation of the market between car users and non-car users, and marketing activity. There are other examples where the desire to grow the market by attracting car users on certain services appears to have led to improvements in bus quality or introductions of new tickets, but these examples are rare (see, for example, Norfolk Green’s approach detailed in Appendix 6.1, paragraph 77). Go South Coast’s Corporate Plan also stated that it sought to be secure in its position as operator of choice (in competition with a number of local bus oper-

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86 Go-Ahead’s initial submission.
87 Go-Ahead’s hearing summary, paragraphs 34 & 36.
88 National Express initial submission.
89 Stagecoach’s initial submission.
ators) and noted that ‘an attractive, innovative, reliable and well marketed bus service will also attract new users from our greatest single competitor in the areas we serve, the private car’.

6.151 The internal documents do not suggest that the threat of existing bus users switching to the car has modified bus operators’ decisions when changing their offerings. We recognize that internal documents may provide only a partial picture of the nature of the constraint from other modes of transport, since, as noted in paragraph 6.58, they tend to document changes to the operating environment, while the presence of other modes of transport is likely to be relatively unchanging. Nevertheless, the available evidence on regular price reviews does not suggest that other modes of transport, in particular the car, provide a constraint on operators’ decisions.

6.152 Car ownership is still increasing (in some areas more than others) and while bus operators have traditionally focused services on areas characterized by a high density of non-car users, demand for bus services in these areas has declined. We have seen evidence, for example in relation to the Tyneside area, that the decline in demand resulting from increased car ownership is viewed by some operators as an immutable trend (see Appendix 6.4—Tyneside, paragraph 4(a)), which is best responded to by increasing fares and cutting back services (see Appendix 6.4—Tyneside, paragraph 5(c)). The car is mentioned only sporadically (in contrast to the continuous monitoring of other local bus operators) in internal papers as a general threat to operators’ businesses. Internal documents contain no specific examples of the threat of existing customers switching away from the bus to the car.

Although FirstGroup told us that it took into account car-park charges when setting its fares (see paragraph 6.146), there is no evidence for this in its internal documents. Similarly, Arriva told us that it took into account car-parking charges in its reviews of fares but in the nine fare strategy documents that Arriva provided, there is no mention of car-parking charges. Instead, the examples we have seen where bus operators made assumptions about demand elasticity all assumed that demand was inelastic in response to fare increases (see Appendix 6.1, paragraph 23).

6.153 There is evidence that attracting car users to use the bus sometimes forms part of bus operators’ strategies. The bus operators have also carried out marketing campaigns. We discuss in paragraph 6.35 above examples where operators differentiated their services in order to appeal to car users. In recent years the Government efforts, driven by the ‘green agenda’ to increase the use of public transport, has, for example, created opportunities for bus operators—as pointed out by FirstGroup (see paragraph 6.12 above). Similarly, we saw an internal document by Go-Ahead which stated that:

in the current climate, there was increased potential for additional modal shift, particularly where car-parking charges had also increased. There was now the potential for the cost of bus travel using the much improved products and with stronger marketing, to be considered a genuine alternative by more people.

6.154 In general, it therefore appears that local bus operators’ efforts to compete with the car manifest themselves mainly through marketing activities, and there is evidence

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90 For example, [\textsuperscript{90}].
91 Although, for example, an Arriva Strategy review noted the increase in second-hand car ownership as ‘background and context’.
92 Arriva noted that the use of fare strategy discussion papers formed one of a number of inputs that influenced fare revisions, and that local management decisions were ultimately taken by the local management team taking into account a variety of local issues.
that operators are able to identify which routes may be targeted for such activities. Examples include:

(a) FirstGroup’s ‘Green Travel Plan’ partnerships with local businesses where season tickets are offered at reduced prices by local businesses. FirstGroup also told us that it saw the ‘Greener Journeys’ initiative launched by the Government in September 2010, aimed at converting 1 billion car journeys into bus journeys in the next three years, as a key opportunity.93

(b) Stagecoach also mentioned the launch of a service aimed at car users, within the Green Travel Plan initiative pursued by NHS Tayside and Perth and Kinross Council.

(c) Various operators introduced marketing campaigns highlighting the increase in the price of fuel and comparing this to the cost of bus travel.

(d) Arriva’s internal papers recorded two instances where modal shift was a stated objective for certain actions taken in relation to services: in relation to service 500 to Glasgow Airport, ‘patronage has exceeded expectations and a continued monitoring of provision has allowed to hone the supply to meet the demand and maximise modal shift opportunities’; ‘Hemel Hempstead Green Line service 797 has been extended to serve Redbourn to help grow the commuter market’.

6.155 We note that the effectiveness of such activities may rely on a more general positive perception of buses, which may require a good quality of service across wider areas, as illustrated by this quote from one business plan from FirstGroup’s Glasgow operating company: [\[\].

6.156 Aside from marketing campaigns, the examples of bus operators making specific changes to their offerings in order to attract car users are limited to the following:

(a) Norfolk Green told us that it introduced a ticket for two people at a 15 per cent discount as a result of changes in car-parking and fuel prices.

(b) NCT provided an example of a fare reduction it had made in order to make its ‘Grouprider’ ticket more competitive with local car-parking charges and its Local Transport Plan 2006/07 to 2010/11 cites reducing the cost of bus travel in relation to the cost of the car as a key aim.94

(c) FirstGroup’s West Yorkshire operating company introduced a group weekly ticket designed to make the bus more cost-effective in comparison with the car. This operating company’s internal documents also note that it made investments in bus quality in order to attract car users.

(d) FirstGroup’s Glasgow operating company invested in bus quality in order to attract car users.

6.157 In addition, there are also some examples of operators changing their offerings in order to encourage travel by non-users, or users of other modes of transport, more generally (without operators specifying which mode of transport):

93 FirstGroup hearing summary, paragraph 4.
94 However, it is not clear that this Local Transport Plan is a commercial document, or whether these aims are motivated by broader policy considerations in partnership with the council, and so might not be evidence on the ‘constraint’ from the car in the same way as other evidence in this paragraph.
(a) In Brighton, Go-Ahead told us that it offered special weekly passes on two routes to try to encourage commuters and students (on each of the routes respectively) to continue to use the bus rather than other modes of transport for the whole of the week (this is not referred to in the internal documents from this operating company);

(b) Go North East told us that it offered discounted returns to certain major city centres in an attempt to attract those passengers with an option whether to use the bus or another mode of transport (this is not referred to in the internal documents from this operating company).

(c) FirstGroup ran a route promotion aimed at non-users in the Potteries.

6.158 We note that these relatively few examples of bus operators changing their services to attract car users can be contrasted with the far more numerous examples of operators changing their offerings in response to head-to-head competition with other bus operators presented elsewhere in this section.

**Competition with other modes of transport**

6.159 There is evidence that on certain corridors where equivalent journeys can be conducted by train, this is taken into account by bus operators when they set their prices and quality of service. This appears to have been the case in certain rural areas and some PTEs:

(a) National Express notes in its 2009 fares board report that train fares are considered when setting prices, but no further details.

(b) First’s Shuttle bus in South Wales—competition both on price and quality; FirstGroup’s Wales (Cymru) operating company reintroduced peak and off-peak pricing in order to remain competitive with the train during off-peak periods. Similarly Stagecoach told us that it had to reduce the frequency of one service and withdraw another because of competition from the rail in South Wales.

(c) Internal documents from FirstGroup’s Bristol, Somerset and Avon operating company show that FirstGroup took into account direct competition with rail on a number of key routes. Reviews of fares and promotions were the focus of the competitive response.

(d) EYMS provided us with some internal analysis it had conducted comparing train and bus prices for 28 bus–rail parallel corridors. Based on this analysis, it offered special day returns on seven of these bus routes. There does not appear to be a general pattern in the level at which these special return prices are set, other than that they are cheaper than the standard price of 1.79 times the single fare. On two of these bus routes, the return train fare remains cheaper than the bus fare; on seven other routes, where a special return is not offered, the return train fare is also cheaper than the return bus ticket.

(e) A document prepared for Arriva’s pricing clinic (see paragraph 6.59 above) in Scotland West notes the constraint from local rail services.

(f) In Oxford and some services in Inverness and between Fife and Edinburgh, Stagecoach operates a distance-based fare structure, but caps the maximum fare on three of its routes, thus reducing the price for longer-distance travel on those routes, in order, it stated, to improve the competitiveness of its offering
compared with the rail fare (this is not referred to in the internal documents from Stagecoach).

6.160 FirstGroup also told us that it competed with the train in Devon. However, Devon County Council told us that in its view there was no competition between bus and rail. [\footnote{\textit{\cite{}}}]

6.161 A small number of large cities also have tram networks and there is evidence that bus operators have changed their offering in response to head-to-head overlap with the tram in some of these areas:

(a) The bus and Metro network overlap on several corridors in Newcastle and this was identified by Nexus as a constraint on local bus operators’ offerings. Go North East’s corporate plan also notes that competition was keen with the Metro in this area.

(b) FirstGroup introduced reduced fares in Sheffield in competition with the tram on certain corridors (this was discussed alongside FirstGroup’s strategy of competition with Stagecoach local bus services—see paragraph 6.57(ii) above).

(c) In Nottingham, Yourbus registered a bus route parallel to the tram on the main road. It believed that this gave elderly people more opportunity to get around on public transport because while there were tram stops every 0.5–1 miles, the bus stops were more frequent at every few hundred metres. The bus fare was slightly lower on some occasions, but there was not much difference in price between the two options and there was also little difference in the time taken to travel, although the bus got passengers closer to their final destination.

6.162 There is very little evidence that taxis or walking constrain operators’ offerings. References in operators’ internal documents and in case studies to competition with taxis or walking are limited to the following:

(a) FirstGroup’s Aberdeen operating company noted that taxis were one of its main competitors, but we saw no documented examples of how, if at all, this impacted on FirstGroup’s offering. FirstGroup told us that it introduced a family/group ticket to make buses more competitive against other modes when groups are travelling together.

(b) In Sheffield, FirstGroup noted that there was a ‘great opportunity’ of encouraging modal shift from walking and taxis as a result of reduced student single fares, but again we saw no documented information on how, if at all, FirstGroup responded. FirstGroup told us that it introduced a family/group ticket to make buses more competitive against other modes when groups were travelling together, and trialled a ‘no-frills’ service serving areas with high student populations and focused on students’ travel needs.

(c) Go-Ahead told us that it regarded the willingness of bus users in Oxford to switch to using a bicycle or to walking, especially for shorter journeys and in the summer months, as a serious threat. According to Go-Ahead, Oxford City Council estimated that 10 per cent of people within the inner cordon of the city used bicycles, and the very features which made Oxford attractive as an area to operate bus services also made cycling attractive (see Appendix 6.4—Oxford, paragraph 44).

6.163 In addition, Stagecoach in Barnsley, following findings from customer surveys, concluded that it should market more heavily the cost-effectiveness of bus over taxi as it found very high levels of taxi usage. However, this document did not recommend any
change in the offering to encourage switching from taxis, and hence does not in itself suggest that taxis are a constraint on Stagecoach’s prices or frequencies, although it might be a constraint on its marketing and advertising activities in Barnsley.

Conclusions

6.164 The evidence set out in this section shows that head-to-head competition with other bus operators is an important consideration when bus operators set fares and service frequencies. We saw extensive evidence of fare promotions and frequency changes carried out on specific competitive routes and some evidence of general fare increases set directly by reference to a competing operator’s fares.

6.165 We also identified instances where the threat of competition led to service revisions. The evidence also suggests that the threat of competition is generally more effective when it is posed by a Large, rather than a Small, Operator and that it is only taken into account at a local level, although sometimes by reference to the behaviour of the operator more generally (eg the stance taken by Stagecoach generally was mentioned as a relevant factor by one operating company).

6.166 The evidence we have received shows that there has been limited entry and expansion95 by operators over the last five years, and that there have been many different types of responses to entry, possibly depending on local circumstances and local management. It appears that on many occasions, operators did not respond at all to entry. Responses often involve an increase in frequency and fare decreases. We also received allegations of spoiling tactics. The scale and intensity of responses to entry also varied, as illustrated by the case studies we carried out, and we received allegations that some of the responses to entry were exclusionary.

6.167 However, in relation to fare reductions and frequency increases, it can be difficult to establish in general terms where the boundaries between normal competitive behaviour (albeit possibly robust) and exclusionary behaviour lie. This is discussed in paragraphs 8.263 to 8.277.

6.168 The evidence suggests that responding to entry by Small Operators is generally easy for Large Operators: fare promotions on specific routes are routinely implemented in response to entry and so are frequency increases; where needed, Large Operators appear able to improve the quality of their service (including by allocating new buses to competitive routes) without difficulty. The evidence also suggests that the impact of the competitive response can be easily measured and adjusted as required. We found that some responses to entry were intense, even though they did not necessarily result in the exit of the new entrant.

6.169 We also noted that the actions taken by the incumbent operator in response to entry are not always reversed when the operator leaves the route (eg FirstGroup in Worcester, Go-Ahead on Abingdon Road, Go-Ahead against RH Transport). But on other occasions, they were (eg competition with ACL in Weston-super-Mare, National Express in Birmingham).

6.170 Although the Large Operators have all emphasized the importance of competition with the car and of achieving modal shift, we found limited evidence in their internal papers and in the course of our case studies that their decisions were driven by such considerations. However, we saw evidence that competition with the car or with other modes of transport is an important consideration on certain specific corridors.

95 Excluding expansion achieved by increasing service frequency on a given route, which is a common event.
Similarly, relationships with local authorities and other local stakeholders are taken into account in relation to network changes, but do not appear to constrain the Large Operators' decisions in relation to fares.
7. Market definition

Introduction

7.1 In this section, we explore the appropriate market definition for the evaluation of competition in the provision of local bus services.

7.2 We recognize that in many instances bus passengers are likely to have a variety of transport options open to them and that, in particular, bus operators’ business is dependent on whether consumers choose to use buses or travel by private car, or by other available modes of transport. However, this does not necessarily mean that these alternative modes of transport are a close competitive constraint. Such constraints arise when a sufficient number of customers would substitute to other modes of travel1 in response to an increase in bus fares from competitive levels.

7.3 If, in response to a small increase in bus fares from competitive levels, passengers would switch from the bus to other modes of travel in sufficient numbers, we would conclude that a hypothetical monopolist of bus travel would not be able profitably to raise bus fares above competitive levels. If this is the case the level of competition between bus operators would be unlikely to have a large effect on outcomes for consumers. However, if passengers would not substitute in sufficient numbers, the extent of competition between bus operators is likely to be an important determinant of outcomes for passengers. This section addresses whether passengers would substitute to other modes of travel in sufficient numbers to make bus travel part of the same relevant market as other modes of travel.

7.4 When we refer to a change in price, this should be read as incorporating any equivalent change in any element of the competitive offer. Operators can vary their offer across a number of dimensions; while they may sometimes seek to win custom by lowering fares, they might also raise frequency, improve the quality of their vehicles, improve cleanliness, etc.

7.5 We investigate whether a bus operator which faces head-to-head competition from another bus operator will behave differently from an equivalent operator which faces no such head-to-head competition from a rival bus operator. We also investigate whether other substitutes (such as other modes of transport like walking, rail services or private cars), or even the option for passengers not to travel, form an equally effective competitive constraint.

7.6 In considering geographic market definition, we assess in particular the ability and incentives of operators in different areas to enter rival territories in response to a small rise in price above competitive levels. It is suppliers, rather than customers, that are most likely to widen the relevant geographic market because, on the demand side, passengers are unlikely to be able to change their chosen journeys.

7.7 CC guidelines note that the CC does not regard market definition as an end in itself but rather as a framework within which to analyse the effects of market features. The CC will adopt the methodology most appropriate in the context of the investigation. It will not devote disproportionate resources to determining exactly whether a particular

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1 In addition, passengers may choose not to travel at all, which will also have an impact on the profitability of a price increase and so is also relevant to our analysis of the relevant market. In what follows, references to alternative methods of travel should be read to include the possibility that passengers may choose to make no journey.
7.8 Competition between bus operators may occur at a number of different geographic levels. For example, some bus operators set fares at the level of an individual fare stage (although this is increasingly rare). Fares and other aspects of the competitive offer such as service frequency may also be set at the route or the network level. As such, no one geographic frame will give a complete picture of the competitive constraints that affect operators’ fares, frequencies and other aspects of their offer. 

7.9 Because of the complexities set out in paragraph 7.8, it is important not to be bound by any particular market definition, but rather to assess competition on an empirical rather than a theoretical basis. Therefore, regardless of the precise geographic boundaries of the market, we assess competition between bus operators at a number of geographic levels (see paragraphs 7.103 to 7.112 below).

7.10 In the rest of this section, we first discuss our analysis of the relevant product and geographic markets for the operation of local bus services (see paragraphs 7.11 to 7.102). In paragraphs 7.113 to 7.120 we discuss the relevant markets for the tendering of supported bus services.

**The relevant product market**

7.11 An important factor in the definition of the relevant product market is the willingness of consumers to substitute to suppliers of alternative products or services in response to a small increase in price relative to competitive levels. We have a range of evidence of the extent to which consumers would switch between local bus services and other modes of travel, some of which also contains evidence about their willingness to switch between competing bus operators:

- survey evidence (NTS, CC Survey, other surveys) and econometric analysis based on this evidence;
- parties’ internal documents, responses to the CC market questionnaire and submissions; and
- comparisons of outcomes in areas with differing levels of observed competition within local bus services (including econometric data analysis).

7.12 The scope of the relevant product market will also depend on the likelihood that a small change in prices (or other elements of the offer) would induce suppliers of other products or services to begin supplying the relevant products or services (supply-side substitution).

7.13 We received no evidence that providers of other modes of transport would quickly and easily switch to the supply of local bus services if prices in the supply of local bus services were to rise by a small amount above competitive levels. The provision of coach services and PSV hire will involve some of the same skills and assets. However, there are differences in the nature of the vehicles required and the relevant

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2 CC3, paragraphs 2.2 & 2.6.
3 For example, analysis conducted exclusively at the flow level (see paragraph 7.80) will not take into account the effects of potential competition, nor will it reflect the fact that many operational decisions such as fares or frequencies or decisions regarding fleet composition are taken at the route or the network level. Similarly an analysis conducted exclusively at the urban area level might better reflect potential competition but would not reflect the possibility that direct competition can provide constraints over and above that provided by potential competition.
local knowledge, and entrants will need to obtain the appropriate licences (if they do not already hold them, including meeting the necessary financial resource requirements) and register services with the Traffic Commissioner at least 56 days in advance. Consequently, we do not consider a move into local bus services to be sufficiently quick and low-cost to form part of the relevant product market.

Evidence of demand-side substitution

7.14 We looked at two broad categories of evidence on demand substitution. First, we considered evidence regarding the loss in sales that would result if a hypothetical monopolist of local bus services were to increase prices, taking substitution to all alternatives together. This allows us to compare the amount of substitution from a monopolist of local bus services to all the alternatives (the market elasticity of demand) with the amount of substitution from an individual operator to its rivals and all other alternatives (a firm elasticity of demand in the presence of a rival operator). Second, we considered substitution to each different mode of transport. This tells us about the relative strengths of the constraint imposed on local bus operators by different alternatives. This can help us to understand what particular local conditions (in terms of the mix of alternatives available to customers) may be important in dictating the behaviour of a particular operator in an area.

7.15 There are a number of possible modes of travel that an individual may use to make a journey. Each is potentially a substitute for bus travel. Ultimately, it is the cumulative effect of all these constraints (and indeed the constraint from passengers choosing not to travel at all) that is determinative of the behaviour of operators. We first consider the extent to which passengers would substitute away from bus travel, either to another mode or to no travel at all, in response to a small change in the competitive offer (the own-price elasticity of demand), bearing in mind that the majority of the evidence on this factor is based on the situation at current prices (and not necessarily competitive levels). We then compare this evidence with what we have found concerning the substitutability between competing bus operators from our customer survey.

Evidence regarding the own-price elasticity of demand

7.16 The elasticity of bus demand with respect to bus prices measures the proportionate change in bus demand in response to a proportionate change in bus prices when all other factors are held constant. At the market level, the own-price elasticity of demand is effectively a summary measure of all of the demand-side constraints operating on a monopoly local bus operator; for a rise in bus price, this change in demand is made up of the sum of demand switched to car, bicycle, tram, walking, all other modes and also demand lost because passengers choose not to travel at all. A firm-level own-price elasticity of demand, on the other hand, would additionally capture the constraint provided by customers’ propensity to switch between bus operators.

7.17 In the case of local bus services, there has been extensive academic work undertaken over many years to assess the size of market demand elasticities. Appendix 7.3 provides a summary of existing estimates. The elasticity estimates vary: short-run

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4 For example, if demand for bus services were to decrease by 10 per cent in response to a 5 per cent increase in bus fares, then the elasticity of demand would be equal to –2. If demand only fell by 2.5 per cent, then the elasticity of demand would be –0.5.
estimates typically range around –0.4, while long-run estimates are higher, ranging from –0.8 to –1.5.5

7.18 These estimates imply that, in the short run, a 10 per cent rise in (all) bus fares might be expected to lead to a fall in demand for buses of around 4 per cent. If that price rise were to persist in the longer run, demand would fall further, by somewhere between 8 and 15 per cent. We might expect to see greater substitution in the long run, as it may take time for some passengers to adjust their travel patterns (for example, by buying a car or bicycle).

7.19 Some of the bus operators described their use of rules of thumb in their planning processes which were consistent with these short-run estimates of the elasticity of demand—see Appendix 6.1, paragraphs 23 and 24. However, a number of operators6 said that the elasticity estimates summarized in Appendix 7.3, or elasticity estimates in general, were subject to a number of flaws, including being based on outdated work, being limited to a national finding and therefore unrepresentative of any individual local area, and ignoring the role of important non-price factors in determining the extent of substitution (see Appendix 7.3). While we accept that these estimates have their limitations, we consider that they form a useful benchmark and sense-check on the further analysis we have undertaken to explore the elasticities in the reference area (including consideration of local areas and non-price factors) which was designed to account for some of the limitations of the pre-existing research. This analysis and what we take from it is outlined below.

7.20 The operators told us that they did not systematically collect evidence or conduct analysis on the extent to which passengers would react to changes in the competitive offer, the extent to which they would substitute between bus operators or the extent to which bus users would substitute between modes, but rather that they considered these issues on an ad hoc basis.7,8 That said, there are some specific examples where they have analysed customer switching behaviour (though the analysis conducted does not usually result in quantified elasticity estimates), summarized in the following paragraphs.

7.21 Stagecoach conducted a survey of passengers on its frequent bus feeder service in Sheffield (the Supertram Link) two years after its introduction. The survey asked customers two questions: how did they travel before the Supertram Link was introduced, and why did they change from their previous travel mode. [\%] per cent of surveyed Supertram Link customers had switched from FirstGroup’s local bus services, of which [\%] per cent said they had switched as a result of lower prices, [\%] per cent because of the new buses, [\%] per cent because of the connection with Supertram, [\%] per cent because of higher frequency, [\%] per cent because of quicker journey time and [\%] per cent because of improved reliability/punctuality. Another Stagecoach internal document noted that it had seen ‘significant shift from car to bus’, allowing it to grow demand on its services.

7.22 In December 2007, FirstGroup commissioned research into the impact of fuel prices on public transport usage, among individuals who either owned or had access to a car at their home, in towns with park-and-ride facilities. The research found that as a result of increased fuel prices, 12 per cent of passengers said that they had reduced

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5 We note that the definition of short and long run differs between studies. For a fuller discussion see paragraphs 5.10 to 5.14.
6 FirstGroup, Arriva, Stagecoach, National Express.
7 National Express said that it did monitor the impact of fare changes on its business, but due to the combination of factors affecting demand, it was extremely difficult to isolate and quantify the impact of changes in relation to different competitive parameters (such as fares, journey times, duration, frequency of service etc).
8 FirstGroup, Stagecoach, National Express, Metrobus (Go-Ahead), Brighton and Hove (Go-Ahead), Oxford Bus Company (Go-Ahead), Go South Coast, Blackpool Transport, Cardiff Bus, EYMS, NCT, Veolia.
their car usage, and 62 per cent had increased their use of public transport. The research found that substantial increases in bus usage might occur after a 50 per cent increase in fuel prices. The research also found that more moderate increases in fuel prices were associated with increases in the proportion of individuals who said that they would use the bus more often. For example, if petrol prices were to rise by a further 10 per cent, 19 per cent of respondents said that they would be very likely or quite likely to use the bus more often. In addition, FirstGroup provided us with examples of several passenger surveys it had conducted to analyse customer switching, but these did not in general provide estimates of elasticities or the levels of switching. In [ ], [ ], these surveys included an analysis of the reasons behind customer choice between bus operators and in [ ], [ ], these surveys were more generally aimed at assessing customer churn and the reasons for this. Considerable research was also conducted in [ ] to analyse customer switching between FirstGroup and [ ], but does not provide quantified analysis of the proportion of passengers that switched between the two operators. FirstGroup also conducted a survey in [ ] aimed at analysing customer switching between bus and other modes of transport.

7.23 Arriva told us that it had in previous years attempted to measure elasticities, but that these attempts had not produced satisfactory results, as they had been judged unrealistic by local management teams, and there were methodological issues that in their view undermined the validity of the results. Arriva provided some examples of the results, which showed some counter-intuitive elasticity estimates. Arriva no longer sought to measure elasticities in this way, but rather reviewed prices in a broader context at each operating company.

7.24 Bournemouth City Transport conducted surveys on two competitive corridors to analyse switching between operators.

7.25 As noted in Section 5, we commissioned two studies of demand for bus services: an econometric study of bus demand using data from the NTS (the econometric demand study) and the CC’s customer survey. More detail on each of these, and the bus operators' comments on them, can be found in paragraphs 5.4 to 5.19 and in Appendices 5.2 and 5.3 respectively.

7.26 Broadly, the results of the econometric demand study are consistent with the findings of previous studies in this area. It found that the overall elasticity of bus demand, from all individuals in the sample, with respect to bus fares is –0.36.

7.27 The results of the CC survey similarly suggest that the market-level own-price elasticity of demand is low, ranging from –0.20 to –0.73 by ticket type for passengers on competitive corridors.

7.28 While most estimates of the elasticity of bus demand focus on changes in demand that result from a change in price, there are also estimates that measure the effect of changes in other elements of the service offered by a bus operator. Existing estimates of elasticities of demand with respect to non-price factors (primarily wait time and journey time) are summarized in Appendix 7.3. Estimates range from –0.25 to –1.7, with the majority of estimates being smaller in magnitude than –1 (ie closer to zero). The CC survey was also designed to measure elasticities with respect to non-price factors. The results of our survey show that customers' responsiveness to non-price factors (frequency, reliability, crowding and cleanliness) also tended to be

11 See Section 13.4 of the CC survey report.
low. The survey shows that elasticities of demand with respect to all the variables measured are very low (smaller in magnitude than –0.5). However, it can be difficult to compare elasticities across different dimensions, particularly where there is no cardinal scale along which those dimensions can obviously be measured (as is the case for crowding and cleanliness, for example).

7.29 With an observed market elasticity smaller in magnitude than –1—as is consistently suggested by most of the evidence outlined above—and where a bus operator faces little competition from other operators (ie the firm-level own-price elasticity of demand is close to the market-level own-price elasticity of demand), a marginal price rise should be profitable even without having regard to cost savings as a result of reduced output. The evidence therefore suggests that the constraint provided by short-term demand-side switching to alternative modes of transport is insufficient to render the price rise unprofitable and therefore insufficient to broaden the relevant market beyond the supply of local bus services.

7.30 The CC survey provides further evidence to suggest that an alternative bus service competing head to head is seen as a significantly closer demand-side substitute than any alternative mode (or combination of alternatives). In contrast to the small market-level elasticities reported above, the survey finds an estimated firm-level own price elasticity of demand of –1.7 (demand response to a 25 per cent price increase). The survey finds that the large majority of customers who switch away from a bus operator following an increase in its prices switch to another bus operator, rather than to alternative transport modes or to not making the trip at all. This suggests that, with regard to short-run demand-side constraints, the relevant product market should not be wider than the provision of local bus services.

7.31 In summary, the available evidence regarding demand substitution shows that, both in the short run and longer term, the market-level own-price elasticity of demand for bus travel is low, and that changes in the fare or service offered by local bus operators have little effect on passengers’ choice of travel mode. Few passengers will substitute away from the bus in response to a worsening of the service or an increase in fare and few will substitute to the bus in response to an equivalent service improvement or fare reduction. This shows that the threat of customers switching to alternative means of transport, or not making journeys at all, is a weak constraint on bus operators’ decisions on how they set their competitive offer. Furthermore, the CC survey provides evidence that, where operators of local bus services compete head to head, customers are sensitive to changes in the offer of local bus operators.

7.32 We therefore found that the threat of switching to alternative modes of transport is not generally sufficient to extend the relevant product market beyond the supply of local bus services and that bus operators are more heavily constrained by other bus operators, where present, than they are by other modes of travel.

Analysis of market outcomes

7.33 In addition to direct evidence of passenger substitution, we looked at market outcomes. If alternative modes of transport were as effective a competitive constraint
on operators as are rival operators, we would not expect to observe any difference in the competitive offer in areas where there are differing levels of competition within local bus services. However, if other modes of transport are a less effective constraint, we would expect to see differences in the competitive offer with more favourable outcomes where competition between local bus operators is stronger. Evidence on the extent to which market outcomes vary with the degree of competition between bus operators can therefore provide valuable insight into the scope of the relevant market.

7.34 Arriva in particular told us that it aimed to provide the same level of service, and targeted the same performance from its business units, regardless of the strength or weakness of the local competitive situation.

7.35 The CC’s performance-concentration analysis compares the outcomes for consumers (bus fares and the frequency of local bus services) across geographic areas and seeks to establish the extent to which competition between local bus operators has an impact on outcomes.

7.36 The performance-concentration analysis found a significant relationship between frequency and concentration at both the route and Urban Area levels of analysis (see Appendix 7.1 for more details). Since higher frequency implies lower load factors, this suggests that operators may run services that are less profitable than average when they face greater local exposure to rival operators.

7.37 The price-concentration analysis found mixed evidence on the relationship between price and the level of concentration. However, it did find an indication that concentration at the route level has an effect on the average price of tickets, implying that greater competitive pressure from rivals leads to lower average prices at that level (see Appendix 7.1 for details). We also found in paragraphs 6.49 to 6.61 that the qualitative evidence we have gathered shows that ongoing head-to-head competition between local bus operators can result in lower fares in the long term as well as improvements in service quality.

7.38 There is further evidence on outcomes from the CC comparison of depot-level margins and concentration (Appendix 10.4). This analysis shows a correlation between the level of local competition within local bus services and the margins that are commanded in the area. This is consistent with the findings of the performance-concentration analysis described above, with operators being less profitable than average where they face greater exposure to rival local bus operators.

7.39 In summary, we found that incumbent operators that face stronger competition from other local bus operators offer a better service. This provides further evidence that other modes of transport are not as effective a competitive constraint as competition between local bus operators. This in turn provides indirect evidence that the relevant product market should not include other modes of travel.

The constraint from individual modes of travel

7.40 We also considered the extent to which customers would substitute between bus travel and other specific modes of travel. We group these alternatives into: flexible modes, where the origin and destination of a trip are chosen by the individual traveler, such as the car, taxi, cycling or walking; and ‘fixed network’ modes of transport such as the bus, rail or tram. The analysis is likely to be of most interest when we

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14 In technical terms, the cross-price elasticities of demand.
think about the implications of our average findings for individual local areas, as the mix of alternatives available to customers can vary significantly from one location to another.

7.41 Regarding flexible modes, we note that nearly any point-to-point journey can be replicated using at least one of these modes.15 ‘Fixed network’ modes of transport, on the other hand, are only viable for point-to-point journeys where the operators of these modes offer a service. We consider both types of mode in further detail below.

Flexible modes of transport

7.42 We were told by many bus operators, as well as various other bus industry participants, that local bus passengers were willing to substitute between the bus and the car in large numbers (see paragraphs 6.145 to 6.149).

7.43 We examined three main sources of evidence to evaluate the strength of the constraint from the car:

(a) First, we looked at the behaviour of bus operators. If passengers switch in large numbers between the bus and the car, we would expect to see significant marketing activity directed at car users. Several examples of initiatives taken by operators to encourage modal shift were provided as detailed in paragraphs 6.150 to 6.158.16 This indicates that bus companies anticipate some prospect of success in persuading individuals to switch to the bus from other modes. In many instances, marketing campaigns have been about growing patronage at a general level, but we have also seen examples of marketing campaigns targeted at car users (paragraph 6.154). In addition, we have observed some instances where operators have changed their offering in order to try to attract car users (paragraph 6.156). This evidence shows that the operators believe there are at least some individuals who might substitute from the car to the local bus. However, it is difficult to assess from examples of marketing activity how many would switch in practice; the existence of examples of targeted marketing would be consistent both with a high elasticity of demand and with a low elasticity of demand.17 The number of such schemes and the investment involved appear modest, which might suggest that operators expect relatively few to substitute from the car to the bus.

(b) Second, the CC survey was designed to measure the extent to which passengers would substitute to and from the car in response to changes in the bus offer. It suggested, as reported above in paragraph 7.27, that there was little substitution away from bus travel to all alternative transport modes collectively in response to a rise in price. Moreover, it found that less than a quarter of the lost custom was diverted to the car (either as driver or passenger).18

(c) Finally, the NTS and the econometric demand study based on NTS data provide valuable information on the extent to which individuals would substitute between the bus and the car in response to small changes in the bus offer. The

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15 For longer journeys, it is clear that walking, in particular, becomes a less viable alternative.
16 Further examples are provided in Stagecoach’s response to provisional findings, paragraph 5.8 and Appendix 2.
17 Examples of marketing initiatives tell us that the operator concerned expected sufficient substitution to warrant the outlay on marketing. However, the substitution necessary to render a marketing exercise profitable might be relatively small and it is possible that even with a small elasticity of demand (consistent with a narrow product market) sufficient substitution would occur to render a marketing exercise profitable. Consequently this evidence does not provide direct evidence regarding whether a small but significant non-transitory increase in price (SSNIP) would be profitable.
18 See Table 16.2 of the CC customer survey report. In response to a 25 per cent rise in bus fare, there is a fall in custom of 8.2 per cent, with 1.8 per cent of passengers switching to car, as driver or passenger.
econometric demand study shows that individuals with access to a car are much less likely to travel by bus than those without such access. However, there is no evidence in these results that substitutability between car and bus travel is affected by car ownership, or holding a driving licence, to a significant degree. All groups, regardless of car access or driver’s licence status, display a low elasticity of demand with respect to bus fares (an absolute value lower in magnitude than –0.5).19 This suggests that regardless of local levels of car ownership, bus operators would lose few sales in response to higher fares and similarly would gain few sales in response to a fare cut. Therefore, the prospect of substitution to the private car provides a very limited constraint on the behaviour of bus operators, at least with respect to fares.

7.44 In response to our provisional findings report, Arriva said that the CC had not provided evidence to suggest that the generalized cost of bus use was sufficiently different from that of alternatives, such that bus stood out on its own as the only option for passengers. It said that the CC had ignored evidence from TAS in respect of this issue, which clearly demonstrated a high degree of competition between the bus and the car. We note that both the econometric demand study and the CC survey control for differences in other elements of the competitive offer. They measure the effect of changes in the competitive offer holding other factors equal. Arriva referred to material in the TAS report of March 2010.20 This material points to a number of qualitative comparisons between the local bus and other forms of transport and concludes that the local bus is at a competitive disadvantage. It also includes a worked example which shows that the generalized journey time by bus on one corridor recently studied by TAS was considerably higher than the equivalent journey by car and that changes in fares would have a relatively small impact on this comparison.

7.45 We note that analyses of this type, based on the generalized cost framework, seek to infer the likely scale of substitution based on a series of assumptions. However, we have direct estimates of substitution, based directly on consumers’ behaviour in practice, available to us from the studies in Appendix 7.3, the econometric demand study and the CC survey. We consider direct empirical observations of the extent of substitution a more reliable guide to the likely consequences of a SSNIP than inferences based on the generalized cost framework. In any event, the TAS generalized cost example broadly confirms the findings of those studies in that it finds that small changes in bus fares (or indeed small changes in other elements of the local bus offer) result in modest levels of substitution between the local bus and the car.

7.46 Go-Ahead said that its acquisitions since 1989 had almost exclusively been in the South of England, where car ownership was high and the economy strong, and that ‘this (largely successful) formula is predicated upon the reality that the market for bus travel can be grown away from other modes, and that local bus services can and do constitute a viable alternative to the private car’. TAS said that:

What is vitally important to the industry’s owners, shareholders and stakeholders is not so much the 6 per cent of travel that currently uses the bus but 94 per cent that is not: it is the prospect of winning at least a proportion of those journeys that will determine the future prosperity of the industry.21

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20 Submission of evidence by the TAS partnership Limited, March 2010, paragraphs 17.1–17.7.5.
21 Submission of evidence by the TAS Partnership Limited, March 2010, paragraph 10.3.2.
7.47 We note that the fact that there are very many individuals who have access to a car, or travel by car, provides no information on the number of individuals who would substitute between the car and the local bus service in response to small changes in the local bus offer. It is the number of individuals that would substitute between the local bus and the car rather than the number that could that determines the strength of the competitive constraint from the car. The evidence provided by the demand studies summarized in Appendix 7.3, the CC survey and the econometric demand study show that very few individuals will substitute between the local bus and other alternatives. This finding is further supported by our analysis of outcomes in paragraphs 7.33 to 7.39.

7.48 Go-Ahead also said that the constraint provided by the car was evidenced by historical transport shift. Bus ridership per capita reached its peak in 1954 and has been declining in proportion to the rise in private car ownership ever since\(^\text{22}\). We note that the broad trend pointed to by Go-Ahead could be the result of many factors, not least changes in income and demographics over the preceding 57 years. As such, this trend could be consistent both with a high degree of substitution between the car and the local bus and with very little substitution between the car and the local bus.\(^\text{23}\) As such, broad trends provide very little information as to the degree of substitution. Formal demand studies are designed to control for the other factors that could explain fluctuations in demand so as to isolate the effect of fares, or other elements of the offer, on demand for local bus services. As we set out in paragraphs 7.17 and 7.25 to 7.28, these studies show that substitution between the local bus and other alternatives is very low.

7.49 In summary, the majority of operators and a number of other parties told us that, in their view, the car was a competitive constraint on local bus operators. In support of this view, operators submitted examples of initiatives and marketing activity that they said were undertaken to induce individuals to substitute away from the car to the local bus. In addition, operators pointed to the large share of journeys accounted for by the car and the general trend of increasing car usage and declining bus patronage.

7.50 However, the examples of marketing initiatives, service changes and the general decline in bus patronage are not sufficient (for the reasons set out above) to show that passengers would substitute in large numbers between the local bus service and the car in response to a SSNIP. Direct evidence on this question is available from the demand studies summarized in Appendix 7.3, the econometric demand study and the CC survey. Together, these studies represent a considerable body of evidence all of which shows that substitution between the local bus and other alternatives, such as the car, is low and is insufficient to warrant a wider market definition. Furthermore, the findings of the demand studies are corroborated by market outcomes discussed in paragraphs 7.33 to 7.39. We therefore conclude that it is not appropriate to widen the relevant product market to include the car.

7.51 Evidence from the CC survey shows that other flexible modes offer a similar level of constraint on bus operators as the private car. The CC customer survey shows which modes passengers would divert to in response to an increase in fares.\(^\text{24}\) In addition to the car, other important alternative modes for the passengers surveyed are walking

\(^{22}\) Go-Ahead response to provisional findings, paragraph 5.7.

\(^{23}\) We note that the model developed by TAS to understand changes in demand since 1986 uses an elasticity of demand with respect to fares of $-0.3$, which implies very low levels of substitution between the local bus and other modes. TAS said that their model proved remarkably accurate in tracking the changes in demand that had taken place since 1986. See submission of evidence by the TAS Partnership Limited, March 2010, section 18.

\(^{24}\) See Table 16.2 of the CC customer survey report.
and taxis. However, diversion to all alternative modes (individually and in aggregate) is low.

**Fixed network modes of travel**

7.52 Fixed network modes of travel can offer a viable alternative to bus travel on some specific point-to-point journeys where local bus and rail or tram services overlap.

7.53 Evidence from the demand study and academic studies appears to show limited constraint overall from other modes, which also implies a limited constraint from fixed modes.

7.54 However, direct overlaps between local bus services and fixed modes are relatively rare. The CC’s customer survey asked bus users what other modes of transport were available to them, other than the bus. Only a very small proportion of bus users told us that the train was available to them as an alternative mode of transport (between 1 and 4 per cent, depending on whether the area was rural, urban competitive or urban non-competitive), and even fewer that the tram was available. Of those customers who would have taken another mode of transport were the bus not available (73 per cent of all respondents), only 2 per cent would have taken the train, and an even smaller proportion would have taken the tram or other light rail.

7.55 We cannot therefore distinguish a weak pervasive constraint (lots of customers with a weak tendency to switch in response to a change in relative prices) from a strong but highly localized constraint (a smaller number of customers with a higher tendency to switch in response to a change in relative prices) with the evidence available to us. We therefore cannot dismiss the possibility that certain fixed modes in certain local areas exert a strong (if localized) constraint on local bus operators.

7.56 Another important factor in considering the nature of the competitive constraint offered by fixed modes is the local bus operators’ ability to discriminate and offer different fares and service levels on flows where there is an overlap with rail or tram services.

7.57 Bus operators could, in principle, discriminate in the quality of service (eg in terms of frequency or model of bus operated) they offer between routes that face an overlap from a fixed network mode and those that do not, and could adjust fares on specific routes (either through route-specific tickets or through route-specific promotions). Such tactics may be unattractive in practice, eg customers and drivers may find different fare structures in an area confusing, and many ticket sales are for season and network tickets which are not route specific.

7.58 We have received a range of evidence on whether operators discriminate by offering different fares on routes where they face head-to-head competition. In general, fares are set at the network level (see paragraph 6.41). FirstGroup told us that, in general, it made fare decisions on a route by route basis and that where fares were set at a network level this was to avoid customer and driver confusion. National Express told

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25 CC survey, quantitative findings report, Figure 5.viii.
26 CC survey, response to Q225 (see data tables).
27 If local bus operators can tailor their fares and services to individual flows or individual bus routes, then the competitive impact or rail or tram services will be limited to those flows or those particular routes where there is an overlap. However, if bus operators’ fares and service levels are determined on an area-wide basis, the existence of competitive overlaps with rail or tram services might also have an effect beyond the immediate overlap. If an effect were observed across a wider area, one would anticipate a price change to be lower in absolute terms if it were spread across routes that face less competition, as well as those that overlap with alternative fixed network modes, compared with the situation where the change affected only the overlap flow(s).
us that, consistent with its product proposition that it operated a regional network, fare adjustments were introduced on a network-wide basis, and that as a result fares on routes on which there was no competition were set at the same level as (and benefit from) routes on which there was competition. We note, however, that in our Birmingham case study we found that National Express had reduced price on three routes in competition with Rotala, but this appeared to be the first time National Express had deviated from its network-wide pricing policy. In addition, many operators do not offer route-specific season and network tickets.

7.59 However, we have seen several examples of route-specific pricing, including route-specific season tickets, route-specific fares and route-specific promotions. Route-specific pricing appears to have been driven by a variety of factors, but often this is as a result of head-to-head competition with another bus operator (see paragraphs 6.49 to 6.61).

7.60 We found that other aspects of operators’ offerings, including frequency of service and vehicle quality, are more likely to vary across routes. We saw several examples of operators differentiating the quality on some of their routes, or targeted fleet upgrades along certain routes. The level of frequency varies considerably across routes.

7.61 Overall, where operators' internal documents refer to the constraint from fixed modes of transport (train and tram), their responses appear to have been concentrated on specific overlap flows and corridors (see paragraphs 6.159 to 6.161).

7.62 It may be therefore that the relevant product market, in certain circumstances, should be widened to include fixed modes of travel. In general, similar criteria should apply to those applied to an assessment of whether overlapping bus services compete. The fixed mode must offer a sufficiently similar journey proposition (in terms of the passenger flow served, fares, frequencies, timetable and journey speed) to present a viable alternative for passengers.

7.63 We found that, in circumstances where fixed modes offer a sufficiently comparable service (in terms of price, journey time and location), they should be included within the relevant product market.

**Conclusion on the constraint from other modes of transport**

7.64 In conclusion, we find that although customers clearly have a choice in many cases between alternative modes of transport, few passengers would switch to an alternative flexible mode of transport in response to small changes in the relative levels of competitive variables such as fares. Instead, the propensity of individuals to use the bus rather than other methods of travel is driven by, for example, whether the individual has access to a car, their income, life stage, how close their home is to a bus stop and the frequency of bus services from that bus stop. While the propensity of individuals to use the bus is clearly important to local bus operators, many of these factors are outside of their control. As such, these aspects of customer behaviour do not act as a competitive constraint on the behaviour of bus operators.

7.65 Where passengers face a choice of alternative fixed modes such as rail and tram, we find that there is a possibility that bus passengers would substitute to these modes in response to a small increase in bus fares. The market elasticity of demand for bus travel may therefore be higher on flows where alternative fixed modes of transport
are available and we find that fixed modes should be included in the relevant product market where such overlaps arise.\textsuperscript{28}

\textbf{The relevant geographic market}

7.66 We next examined the geographic area over which competition occurs between bus operators.

7.67 As noted in the CC market investigation guidelines,\textsuperscript{29} the geographic boundaries of a market are generally defined using the same principles as the product market; if consumers or suppliers will switch between areas in response to small changes in the competitive offer or market opportunities, competition in those areas will be closely linked and they can be regarded as being within the same market. If competitive conditions in one of two areas can change without inducing a reaction in either consumers or suppliers, the areas are distinct geographic markets.

7.68 Competition in the local bus industry might take the form of both head-to-head competition, where the constraint on operators is driven largely by demand-side substitution, and potential competition and new entry, where the constraint on operators is driven largely by supply-side substitution. For any given pair of operators, we find that the constraint from head-to-head competition is likely to be stronger than the constraint from potential competition.

7.69 In the following sections, we begin by setting out the views of local bus operators on the appropriate geographic market definition. We then consider the implications of additional evidence on the demand-side and supply-side constraints facing local bus operators.

\textbf{Views of local bus operators on geographic market definition}

7.70 FirstGroup told us that in its view the appropriate geographic market for local bus services was no wider than the route level, and that there was significant variation across different routes. FirstGroup said that ‘on the demand-side, a particular journey for a passenger to a destination is not a substitute for another destination in the local area’. FirstGroup noted that it ran its business at the local level, splitting its business into 14 operating companies, and noted that it and other operators took a route-level approach to running their businesses, analysing route profitability using route costings, budgets and trends in passenger numbers. As a result, FirstGroup argued that on the supply side the appropriate geographic market for local bus services was no wider than the individual route.

7.71 However, FirstGroup also told us that bus operators were constrained by the threat of potential competition from operators which did not currently operate on the route, but which were present in the locality. FirstGroup said that, broadly, the extent to which this was possible could be measured by the distance of the rival operator from that particular route in terms of ‘dead running time’ from the depot to the start of the route and the length of the route itself. FirstGroup considered that the approach adopted by the CC in previous cases, considering depots up to 35 minutes’ drive-time away, reflected its practical experience and was a useful rule of thumb.\textsuperscript{30}

\textsuperscript{28} Where a fixed mode supplies the same flow and provides a sufficiently similar service (in terms of fares, frequency and journey time) for passengers to see the fixed mode as an alternative to the local bus service.

\textsuperscript{29} CC3, paragraphs 2.23–2.26.

\textsuperscript{30} FirstGroup initial submission.
7.72 Arriva told us that markets were local and that there was considerable variation across local markets according to demographic and geographic characteristics, the attitude of LTAs to buses and local infrastructure such as hospitals, universities and labour markets. It said that markets could not be neatly segmented across the UK and that markets could have mixed characteristics in any one area. Arriva suggested that there was a distinction between demand- and supply-side constraints. It noted that customer demand was driven by individual flows, and so the local market was defined at this level on the demand side. However, Arriva also noted that markets were sometimes relatively wide as a result of operators being able to serve routes from relatively distant depots, and that individual depots might serve a number of different markets—rural, urban and inter-urban.31

7.73 Go-Ahead told us that markets for local bus services were very localized. It gave the example of its North-East operating company operating 50 different branded services that corresponded to 50 local markets.32

7.74 Stagecoach told us that although demand-side substitution may point to competition between point-to-point flows, supply-side factors tended to imply wider markets, due to operators’ ability to switch capacity (including spare capacity) between different routes at relatively short notice. Stagecoach told us that the appropriate geographic market definition may differ across the UK. It gave the example of an operator in a rural area that might be more willing than an operator in a dense urban environment to serve routes located further away from its depot. Stagecoach said that the appropriate geographic market definition was not, in its view, likely to correspond to a network of local bus services, as competition was focused on individual routes, flows, services, or was based around depots, outstations and bus parking facilities.33

7.75 National Express told us that, in relation to commercial services, the constraint from other local bus operators occurred in two ways. First, it told us that operators exerted a constraint on each other through direct head-to-head competition along certain routes and flows. Second, it said that operators were constrained by the threat of entry and expansion by other local bus service operators, and that this constraint could occur on an individual flow/route/corridor, or could occur at the network level (particularly if the threat of entry or expansion was by another large bus operator). National Express told us that from a demand-side perspective, the relevant geographic market was likely to be very narrow, based on or around individual flows or routes, as different routes or flows were unlikely to be substitutes for customers. However, it told us that from a supply-side perspective, bus operators could move vehicles and assets between routes easily and at very low cost, suggesting that broader transport markets may also be relevant to the CC’s analysis.

7.76 Lothian Buses told us that geographic markets for local bus services were local, and that these local markets varied considerably. It submitted that the geographic market in which it operated was broadly similar to the Greater Edinburgh Competitive Area.33

7.77 Transdev told us that the relevant geographic markets for local bus services were local, and that local markets differed in their expectations of and requirements for local bus services. It said that it managed its business with a local focus.34

31 Based on Arriva hearing summary, paragraphs 37–39.
32 Go-Ahead hearing summary, paragraph 31.
33 An approximation of the Greater Edinburgh area, as outlined by the OFT in its First Edinburgh/Lothian decision No CA98/05/2004.
34 Transdev initial submission.
7.78 EYMS told us that customers might have a choice between local bus operators to complete a given journey. Customers might also have a choice of destination or pick-up, dependent on their perception of bus availability, quality and value for money, and the availability of alternative locations for shopping and leisure activities and, in the long run, for employment. As a result, EYMS told us that head-to-head competition should be analysed not just at the route level but also at wider network or regional levels. We note that no other bus operator suggested that geographic markets were wider than the route level on the basis of demand-side factors.

Demand-side substitution between geographic areas

7.79 As noted by the bus operators in paragraphs 7.70 to 7.78, individual passengers are usually interested in a journey from a particular origin A to a particular destination B. A passenger intending to travel from A to B is unlikely to view a journey from A to C as a good substitute.

7.80 Local bus services provide transport between fixed origin and destination points, namely bus stops. Passengers using the local bus to make a journey will need to walk to a bus stop to catch the bus and walk from the bus stop where they alight to their final destination to complete their journey. A bus service that offers transport between two bus stops will therefore be able to serve all the individual passenger journeys with origin and destination pairs that are within reasonable walking distance of those bus stops. We refer to all the passenger journeys that can be served by a bus service between two bus stops as a ‘passenger flow’ (flow).

7.81 Where two separate bus services serve the same passenger flow they can be said to ‘overlap’ in that passengers using one service can use the other service for the same journey. This might be the case, for example, if two bus services serve the same pair of bus stops or where two services serve bus stop pairs that are sufficiently close to each other that they serve a similar flow. Where two separate bus services serve a different passenger flow, individuals are unlikely to be able to use these services to make the same journey and so are unlikely to substitute between them.

7.82 Typically bus operators run buses along a specified bus route, which will travel between several bus stops and so will serve multiple flows. Many elements of the bus service such as frequency, type of buses and sometimes fares can be set at the route level. For the purposes of this investigation, we refer to routes that ‘overlap’ as those that provide passengers with a choice of operator for one or more of the flows served by the route. We discuss how we measure the degree of overlap between routes in Appendix 8.1.

Supply-side substitution between geographic areas

7.83 On the supply side, we consider whether an increase in fares above competitive levels (or an equivalent change in other elements of the bus service) would induce

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35 It is important to note that there are a number of factors other than geographic overlap (eg fares, service quality, relative frequency and whether the services operate at the same times of day) that will affect passenger substitution in practice.
36 In previous transport inquiries, the CC has used a variety of catchment areas to establish bus stops that are sufficiently close to constitute an overlap, depending on the service being considered and the geographic setting. See Review of methodologies in transport inquiries, by Kate Collyer, Anthony Felet and Tom Kitchen, CC occasional paper (May 2007), for a summary.
37 The circumstances under which demand-side substitution between non-overlapping flows might take place are described by EYMS in paragraph 7.78. Passengers using a particular flow may have a choice of destination or may have the possibility of choosing a different journey. We consider it unlikely that a sufficient proportion of passengers would change their origin or destination (typically the location of their home, the location of their place of work, or the location of a key destination such as a hospital or shopping area) in response to a small change in the local bus offer on a flow.
operators, not currently operating on the same or overlapping routes, to start providing overlapping services and so render the fare rise unprofitable.

7.84 We examine two important aspects of the constraint from supply-side competition. First, we assess the geographic extent of this constraint. We then consider the available evidence regarding the strength of the constraint from operators within that radius.

7.85 The relative strength and geographic scope of supply-side constraints facing operators might have different implications for the relevant geographic market definition. Taking the narrowest possible market (the flow) as a starting point, there are three broad possibilities for the relevant geographic market depending on the relative strength and scope of the supply-side constraints on operators’ services:

(a) If a small increase in fares, above competitive levels, on a flow would be insufficient to induce any rival operators to commence the supply of directly competing services on that flow, the relevant geographic market will be no wider than the flow.

(b) If a small increase in fares, above competitive levels, on a flow would be sufficient to induce rivals that have existing services and facilities within a certain geographic radius to commence the supply of directly competing services on that flow, but insufficient to induce other firms outside that radius to do so, the relevant geographic market will be wider than the flow level but limited by the geographic radius over which operators can supply bus services.

(c) If a small increase in fares, above competitive levels, on a flow would be sufficient to induce rival operators, regardless of the location of their existing services and facilities, to begin the supply of directly competing services, the relevant geographic market would be at least as large as the entire reference area.

7.86 We note that the strength and geographic extent of the constraint from entry are important questions in themselves, regardless of how we classify the constraint for the purposes of market definition.

7.87 We distinguish between potential competitors and new entrants. A potential competitor is an operator with existing services and facilities nearby. Operators without existing services and facilities nearby are classified as new entrants. New entrants face additional costs over and above those faced by a potential competitor. Operators told us that they faced difficulties when supplying flows that were a long distance from their existing services and facilities, including the costs associated with dead mileage and the need to provide drivers with breaks when operating a service a long way from their depot. We discuss the constraint offered by potential competition and new entry on incumbent operators in detail in paragraphs 8.103 to 8.165.

7.88 We asked the Large and Mid-Sized Operators how close a depot needed to be located in order to serve a flow, and we asked all operators what maximum dead mileage they tolerated on all of their routes.

7.89 FirstGroup, Stagecoach, National Express and Transdev all told us that a useful rule of thumb for how far it was possible to operate from a depot or outstation was around 30 to 35 minutes’ drive-time. Arriva’s estimate was somewhat lower at 20 to 30 minutes’ drive-time from a depot. Go-Ahead in Brighton and Hove submitted that routes needed to be located within 20 miles of a depot. Go South Coast and
Transdev Blazefield told us that they would expect a depot to be located within 5 miles of the main route locations.

7.90 On individual routes, the amount of dead mileage that is tolerated varies across operators and across areas but can be substantially higher than the general rules of thumb discussed above. Further details of the evidence we received from operators is set out in Appendix 7.2.

7.91 We conclude in paragraph 8.164 that the constraint on incumbent operators from potential competition and new entry varies according to local conditions.

7.92 Consequently the likelihood that a small increase in fares above competitive levels on a particular flow will induce other operators to substitute into the supply of services on that flow will depend on local conditions. Given the additional costs associated with new entry, we find it unlikely that operators without existing services and facilities nearby would commence the supply of directly competing services in response to a small increase in fares on a flow.

7.93 In paragraphs 9.210 to 9.226 we find that there are a number of barriers to entry and expansion which have the effect of reducing the strength of entry or potential competition as competitive constraints. We also note in paragraphs 9.206 to 9.209 that some of the barriers to entry apply in every relevant market.

7.94 We also note that the actions of operators can also provide evidence of the relative strength of the constraint from potential competition and new entry. If the constraints from potential competition and new entry are strong, we would not expect to see significant differences in the fares and service offered on routes facing greater head-to-head competition, when compared with those that face less head-to-head competition. Similarly, when the degree of head-to-head competition changes following entry, we should see muted responses to entry as the incumbents’ fares and other aspects of its service are already constrained.

7.95 The performance concentration analysis at the route level shows that the number of competitors present on a route affects the frequency of service on that route. On average, an additional competitor on a route results in a frequency that is 12 to 15 per cent higher. This analysis is set out in detail in Appendix 7.1. This analysis shows that incumbent operators that do not face head-to-head competition have been able, on average, to maintain services that are less frequent than would be the case if they faced head-to-head competition and therefore provides evidence that head-to-head competition is a more powerful constraint than potential competition and new entry.

7.96 In paragraphs 6.105 to 6.142, we set out the available evidence regarding incumbents’ responses to entry. In practice, as set out in Section 6, we see a mixture of effects, but fare reductions and frequency increases in response to entry are relatively common, which indicates that, at least in those cases, head-to-head competition was a more powerful constraint than potential competition and new entry.

Conclusions on geographic market definition

7.97 We find no evidence to suggest that customers would substitute to another flow in response to a small worsening of an operator’s offering on that flow. Therefore the constraint on operators from demand-side substitution alone suggests that geographic markets should be defined at the level of an individual flow.
However, we also find that the prospect of entry by operators that do not currently run directly competing services can impose a constraint on operators' behaviour in some circumstances. The factors that determine the precise constraint from potential competition and new entry are set out in paragraph 8.115.

For the reasons set out in paragraph 7.92, it is unlikely that operators without existing services and facilities within approximately a 30-minute drive-time from a flow (ie new entrants) would substitute into the supply of services on that flow in response to a small increase in fares above competitive levels. Whether potential competitors would substitute on to a flow will depend on the particular conditions in a local area, as well as the characteristics of the potential competitor, which we discuss in paragraph 8.149.

We note, however, that potential competitors and new entrants face a number of barriers to entry, as set out in 9.210 to 9.226, which will limit the strength of the constraint that is imposed by potential competitors and new entry and suggests that potential competition and new entry will offer a less effective constraints on incumbent operators than head-to-head competition.

Evidence on outcomes provides further evidence that potential competition and new entry are less effective constraints on incumbent operators than head-to-head competition. The performance-concentration analysis at the route level shows that, on average, an additional competitor on a route results in a frequency that is 12 to 15 per cent higher. We also note the many examples of significant reactions to new entry. This evidence suggests that on most routes incumbent operators, that do not face head-to-head competition, can maintain a significant reduction in frequency without inducing a potential competitor to begin supplying directly competing services.

We conclude that generally, the constraint from potential competition (and new entry) is insufficient to prevent a small price rise, as shown by the fact that incumbent operators operating routes that do not face head-to-head competition are able to maintain higher fares and lower service qualities than operators that face head-to-head competition. We therefore conclude that geographic markets will generally be at the flow level.38

Geographic units for the analysis of competitive effects

We analyse competition between bus operators at a number of different levels for a number of reasons:

(a) First, demand- and supply-side substitution take place at different geographic levels. Passengers substitute between local bus services on individual flows. However, supply-side substitution takes place over a wider geographic area. Even where potential competition is not sufficiently strong to render a SSNIP unprofitable (and thereby warrant a wider geographic market), the relative strength of potential competition will still be an important driver of consumer outcomes.

(b) Second, the bus industry in practice is more complex than the simple models of competition that underpin the SSNIP test. A mechanical application of the SSNIP framework might suggest that operators would set fares and other elements of

38 Although these results do not preclude the possibility that in a small number of markets there is a potential competitor that offers a sufficient competitive constraint to warrant a wider geographic market definition.
the competitive offer at a flow level. However, this is rare in practice because flow level fares are confusing for passengers and difficult to manage effectively. In practice, operators tend to set their competitive offers at the route and even the network level. Consequently, whilst firms might seek to win passengers from each other at a flow level, they will do so by changing their offer at a route or a network level.

7.104 By conducting our analysis over a range of geographic units we capture different competitive pressures acting on operators.

7.105 To reflect and analyse the effects of demand-side substitution and to understand the extent and importance of head-to-head competition, we examined concentration at the route level (see Appendix 8.1), and part of the performance-concentration analysis was conducted at the route level (see Appendix 7.1) taking into account that passenger substitution will occur on individual overlap flows.

7.106 As noted above, when considering the extent of potential competition, the evidence suggests that the geographic frame is appropriately defined more broadly than just at the route level, as supply-side substitution would be possible by operators located up to 30 minutes from a flow.

7.107 There are various geographic levels which may be used as units of analysis above the route level, including Urban Areas, areas around depots, LADs and LTAs. We recognize that none of these units is necessarily a perfect unit of analysis, or reflects perfectly the range of supply-side substitutes, or other constraints, that a given operator will face. As a result, our analysis was conducted over a range of geographic units. For example, the performance concentration analysis examines the relationship between performance and concentration at the Urban Area level, as well as the route level discussed above; our work on depot profitability in Appendix 10.4 analyses the relationship between margin and concentration at the depot level and within a 12-km radius of a depot.\(^{39}\) We also present and consider measures of concentration at the LTA level and the Urban Area level (see Section 4).

7.108 Overall, we judge LTAs to be too large to capture accurately the supply-side substitutes for local bus operators, and as such their use may overstate the number of possible supply-side substitutes. LTAs are likely to include operators located further than 30 minutes’ drive-time of each other and their boundaries, defined for administrative purposes, are unlikely to correspond closely to relevant supply-side or demand-side constraints on local bus operators. Furthermore, competitive conditions may vary between local markets according to population demographics. We note that broader geographic areas, such as LADs or LTAs, are likely to encompass several centres of population and hence are less likely to capture relevant local demographic variation.

7.109 We conducted a margin-concentration analysis at the depot level, as a reflection of the way that most operators record and manage their costs. We acknowledge the importance of depot location. However, operators’ offerings, in terms of price, frequency of service and the network of services provided, are not set at the depot level. As a result, we find that depots are inappropriate for relating various measures of operators’ offerings with concentration.

7.110 We have defined Urban Areas to correspond to existing networks of local bus services around centres of population above 30,000 (see Appendix 4.2). Where two

\(^{39}\) 12 km represents the approximate distance that a bus will travel in 30 minutes at typical road speeds.
operators' services are located within an Urban Area, it is likely that these operators are within a 30-minute drive-time of each other, and hence would be considered supply-side substitutes. Given the size of the Urban Areas, concentration within these areas is likely to better capture the degree of potential competition than the equivalent at the LTA level. In addition, it is easier to assess some aspects of operators' performance using Urban Areas rather than depots. For example, operators sometimes conduct 'network-level' price reviews (see paragraph 6.41) that broadly coincide with our defined Urban Areas. This suggests that in some instances, Urban Areas correspond to the level at which bus operators make pricing decisions.

7.111 We recognize that certain Urban Areas may be so large that an operator located on one side of the conurbation will not be within a 30-minute drive-time of flows on the other side of the conurbation, and hence may not be direct supply-side substitutes with each other. In these circumstances, measuring concentration at the Urban Area level would understate the constraints on operators. Conversely, shares of supply in some Urban Areas may overstate the degree of concentration if operators located outside or nearby the Urban Areas also exert a relevant competitive constraint. Therefore, we also assess shares of supply in a 12-km buffer around Urban Areas to recognize the fact that in some instances operators located outside but near to an Urban Area may be supply-side substitutes.

7.112 Our analysis of Urban Areas includes operators which run services in the Urban Areas, and in many cases this will include services run from operators’ depots located outside the Urban Area. The fact that services within this Urban Area are already run from such depots suggests that these operators might be considered supply-side substitutes to routes within the Urban Area.

**Tendering of supported services**

7.113 We first consider whether tendered services are part of the same markets as commercial services in regard to the provision of local bus services. Second, we consider market definition in relation to the tendering of contracts for the supply of supported bus services (see Section 13).

7.114 For passengers, supported bus operations provide a service in the same way as they would for a commercial route. Indeed, on many supported routes passengers would be unaware that they are travelling on a tendered service. A passenger is therefore likely to substitute between supported and commercial bus services in those cases where they provide an alternative for the passenger’s journey. It is our understanding that overlaps between tendered and commercial services are rare, because if there is an existing commercial service which would allow passengers to make their journey, then there will be no reason for an authority to provide a tendered service. However, overlaps might occur, for example, where routes converge on key corridors. There is also no evidence that passengers on tendered services are more (or less) likely to substitute to alternative modes of transport than are passengers on commercial services. We conclude that commercial and supported services are both part of the relevant markets for the provision of bus services.

7.115 The second group of customers for supported services are the LTAs that commission the services. In this case, the relevant market is for the tendering of contracts for these services. We have seen no evidence that a small price rise for a tendered service would induce local authorities to substitute to alternative modes. Each tendered contract fulfils a specific need, and where commercial services exist, no tendered service is necessary.
On the supply side, for many tendered contracts there should be a range of suppliers that could successfully bid. For most contracts, an operator with an existing presence in the local area could offer a bid for a contract in that same area. As a result, for most tenders, the pool of potential bidders is not limited to existing suppliers of supported services, but will also include commercial operators in the area. For tenders involving a large enough collection of routes to justify new facilities, the pool of potential bidders may extend beyond the local area.

We found that for some tenders the specification of the contract (for example, if a certain type of bus is stipulated) limits the pool of potential bidders (see Section 13). This will give an advantage to those bidders that are better able to meet those requirements. We also found that in some cases the incumbent operator of a contract can have an advantage when the contract is retendered. However, we found no evidence of a systematic advantage to existing tendered operators when bidding for other tendered contracts.

In some cases, supported services are not put out to tender, eg where LTAs procure a service from a single operator on a de minimis basis because it is considered that only one operator may be well placed to offer the service and for a small contract the costs of undertaking a tender process are not justified (see paragraphs 13.109 to 13.113). However, in this case the market could potentially include other local bus service operators, whether or not the customer (the LTA) chooses to approach all potential suppliers.

This indicates that the relevant market for tendered services should include all local bus operators in the area regardless of whether they offer tendered services, commercial services or both. The fact that commercial operators in the local area could substitute into the supply of tendered service does not necessarily mean that the reverse is also true and that operators offering tendered services only could easily substitute into the supply of commercial services. We have seen examples of operators using tendered services as a ‘stepping stone’ in order to enter the supply of commercial services in a new area. However, this tends to be a relatively slow and incremental process. In addition, operators (both commercial and tendered) are subject to barriers to entry and expansion, which are discussed in more detail in Section 9. Operators that provide tendered services only will not have an existing network of commercial services and so will face similar difficulties to a new entrant (see paragraph 7.92) and will be particularly affected by the barriers associated with network effects (see paragraphs 9.66 to 9.127). Operators that supply tendered services only are also likely to be relatively small and therefore likely to be particularly affected by the barriers to entry associated with incumbent responses (see paragraphs 9.33 to 9.57) and retaliation (see paragraphs 9.58 to 9.65).

We therefore conclude that the relevant product market for the tendering of supported services will include all operators capable of bidding for a tender. Typically this will include both tendered and commercial operators in the local area but the specific requirements of the tender itself may restrict the pool of available bidders. We analyse competition for the tendering of supported services separately from the provision of local bus services, taking into account that there may be linkages between commercial and supported operations. We analyse this and other aspects of the supply of tendered services in Section 13.
8. **Competition between bus operators**

8.1 In this section, we describe the different ways in which bus operators can impose a competitive constraint upon each other, examine the extent of competition between bus operators and explore the conditions under which competition of different forms will arise. We also explore the factors which reduce the extent to which a bus operator is constrained by competition from other operators.

8.2 We first examine the constraint from head-to-head competition in paragraphs 8.3 to 8.100. We then assess the constraints from potential competition and new entry in paragraphs 8.103 to 8.165. We discuss the prospect that competitive constraints might be reduced by operator behaviour first in relation to geographic market segregation in paragraphs 8.166 to 8.262, and second in relation to exclusionary conduct in paragraphs 8.263 to 8.277.

*Head-to-head competition*

8.3 In this section, we explain what head-to-head competition is and the benefits that it brings to customers (see paragraphs 8.4 to 8.8). We examine the extent to which we observe it in the reference area (see paragraphs 8.9 to 8.17) and consider explanations for why we might observe less head-to-head competition than we would expect (see paragraphs 8.18 to 8.92).

*What is head-to-head competition?*

8.4 Head-to-head competition describes the situation where rival local bus operators compete for passengers who face a choice of bus operator for their journey. This arises where operators serve the same flow (see Appendix 8.1).

8.5 Head-to-head competition can take place over the entire length of a route or over a section of it. So long as any overlap is sufficient to provide an alternative for some passenger journeys there will be some head-to-head competition between operators. However, the intensity of head-to-head competition between two operators will depend on the similarity of service provided by them, both in terms of the passenger flows they serve and in terms of the nature of the service that they offer on those flows, as this will determine the number of passengers who view them as substitutes.1

8.6 Our consumer survey found that a small improvement in an operator’s competitive offer was much more likely to attract customers from a rival operator than it was to attract them from other modes of transport (or from ‘not travelling’—see paragraph 5.46). In other words, the ‘business stealing’ effect of an improved offer was far in excess of any ‘market expansion’ effect. This means that competition between bus operators, where it occurs, is likely to be vigorous. We explore the nature of head-to-head competition further in paragraphs 8.39 to 8.81.

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1 We consider that head-to-head competition is effective if it constrains the behaviour of a bus operator so that fares, frequencies and other aspects of its offer are at competitive levels. This occurs where a sufficiently large proportion of passengers would substitute to another operator in response to a reduction in the value of an operator’s competitive offer. This will depend on the proportion of passenger journeys occurring where overlaps apply, and whether customers are likely to switch (e.g. depending on whether rival services operate at similar times, with similar frequency, journey times and so on). In the remainder of this section, we use the term ‘head-to-head competition’ to refer to overlaps which result in effective head-to-head competition.
The benefits of head-to-head competition

8.7 As outlined in our discussion of market definition in Section 7, we find that competition between local bus operators is a greater constraint than other constraints such as from alternative modes of transport. As such, head-to-head competition drives beneficial outcomes for customers.

8.8 This is what we observe in practice. As discussed in paragraphs 7.35 to 7.39, our performance concentration analysis found both a statistically and economically significant relationship between frequency and concentration at both the route and Urban Area levels of analysis (see Appendix 7.1 for more details of this analysis), suggesting that greater head-to-head competition leads to higher frequency of service—something that customers value (see paragraphs 5.26 to 5.31). We also found from the qualitative evidence that we gathered that ongoing head-to-head competition between local bus operators can result in lower fares in the long term as well as improvements in service quality (see paragraphs 6.49 to 6.61). These findings show that head-to-head competition, where present, delivers significant benefits for customers.

The extent of head-to-head competition

8.9 Our analysis of the extent of head-to-head competition in the reference area is set out in detail in Appendix 8.1.

8.10 We began by considering the share of supply of the largest operator in Urban Areas across the reference area. Urban Areas are on average highly concentrated, and this suggests that in many parts of the reference area some passengers are unlikely to have a choice of operator. Nevertheless, the extent to which share of supply information can be used to assess head-to-head competition is limited, as such information does not reveal how rival operators’ networks are located in an area (ie whether they serve the same or different passengers in an area). Our assessment of shares of supply and their relationship with the extent of head-to-head competition in an area is set out in Appendix 8.1, paragraphs 6 to 10.

8.11 Given the limitations of shares of supply as a measure of head-to-head competition, we assessed the extent to which passengers have a choice of operator more directly. We decided that a flow-level analysis was not practicable in the context of this market investigation (see Appendix 8.1, paragraphs 11 to 15), and instead used a method based on calculating the extent to which operators’ routes overlap.

8.12 Bus routes comprise a series of passenger flows. As such, the greater the extent of overlap faced by an operator’s route, the greater the number of flows on that route which are likely to face head-to-head competition. Similarly, the greater the extent of overlap between rival operators’ routes in an area, the greater the share of flows in that area that are likely to be subject to head-to-head competition. Details of how we measured overlap between rival operators’ routes is set out in Appendix 8.1, paragraphs 16 to 48.

8.13 Drawing inferences about flow-level competition using route overlap is complex because we do not have information on the location and importance of the passenger flows that make up each route, and so are unable to assign weight to different overlapping route sections. Two routes facing an overlap of the same length may have a substantially different proportion of passengers subject to head-to-head competition, depending on the distribution of passenger journeys on the two routes.
For this reason, we were restricted to drawing firm conclusions on the extent of head-to-head competition in extreme cases where a route faces only very limited overlap from a rival operator, or where a route faces overlap from a rival operator that covers all or nearly all of its total length. In particular, on routes that faced no overlap of 3.2 km or longer from a rival operator’s route with a regularly overlapping timetable no more than a small minority of passengers will be subject to head-to-head competition. We considered that routes in this category do not face effective head-to-head competition. For routes that faced an overlap of 90 per cent of their length or more from a rival operator’s route with a regularly overlapping timetable, all or nearly all passengers will be subject to head-to-head competition. Consequently routes in this category face effective head-to-head competition.

A number of operators criticized our approach to assessing head-to-head competition, and their comments are set out in Appendix 8.1, paragraphs 49 to 70. We considered these comments carefully, and our responses are set out in the appendix. We conclude that although the link between route-level overlap and head-to-head competition for passengers is not straightforward and our overlap measures have a number of limitations, our approach of using route-level overlap to make certain inferences about the extent of head-to-head competition in the reference area is valid.

The full results of our analysis are set out in Appendix 8.1, paragraphs 71 to 94. We find that practically all routes in the reference area face some overlap from a rival operator. However, of these routes:

(a) 46.2 per cent, accounting for 63.4 per cent of all weekly services in the reference area, face such limited overlap that they do not face effective head-to-head competition.

(b) 2.5 per cent, accounting for 1.4 per cent of all weekly services in the reference area, face overlap from a rival operator’s route over all or nearly all their length, and so are likely to face effective head-to-head competition.

(c) 51.3 per cent, accounting for 35.2 per cent of all weekly services in the reference area, face an overlap that may or may not provide a substantial proportion of passengers a choice of operator. For these routes, a lack of flow-level information prevents us from drawing firm conclusions on the extent to which they face head-to-head competition. Nevertheless, the extent of overlap faced by these routes suggests that, at least in a substantial number of cases, a large proportion of passengers on these routes are unlikely to have a choice of operator.

We find that, although there is local variation between areas in the proportion of routes that fall into each of the overlap categories, in the vast majority of Urban Areas a substantial proportion of services do not face effective head-to-head competition. Similarly, in the vast majority of Urban Areas only a very small proportion of total weekly services are accounted for by routes that we are able to identify as facing effective head-to-head competition.

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2 The 3.2 km threshold is explained in Appendix 8.1, paragraphs 27 & 28.
3 These thresholds do not tell us whether head-to-head competition will be effective for routes that face overlaps of more than 3.2 km and which account for less than 90 per cent of their length.
Why is there not more head-to-head competition between bus operators?

8.18 Having found that head-to-head competition between bus operators drives important benefits for customers, but is uncommon, we now examine the reasons why this might be the case.

8.19 One possible reason for a lack of head-to-head competition is geographic market segregation. We found that, in respect of some parts of the North-East of England, this factor has resulted in less head-to-head competition than would otherwise be the case. We discuss this topic in more detail in paragraphs 8.166 to 8.262.

8.20 Some of the operators told us that insufficient demand was the main reason for a lack of head-to-head competition. Arriva told us that ‘what one often sees is operators overlapping on parts of the route where there is sufficient demand, and serving other parts with no competition where there is insufficient demand for more than one operator to operate profitably’. Stagecoach said that the ability of a route to sustain more than one operator will depend on a combination of the potential profit available to each operator and whether that is sufficient for sustainable competition, the ability to obtain efficiencies by operating the whole service and its relationship with other routes in the area (in terms of scheduling and interworking).

8.21 We note that low levels of demand of themselves are insufficient to explain why there is only one company in a market. Even very small levels of demand might still sustain multiple competing companies. Other factors, such as the economies of scale available in the industry, combined with low demand, are needed to explain why only one company is able to survive.

8.22 We explore two possible explanations for the low incidence of head-to-head competition in the local bus industry:

- First, we examine the possible existence of route-level economies of scale or other supply-side efficiencies (see paragraphs 8.23 to 8.38).

- Second, we consider the suggestion that head-to-head competition is not sustainable because certain characteristics of the supply of local bus services give operators incentives to behave in a way that creates instability and overcapacity (see paragraphs to 8.39 to 8.81).

Route-level economies of scale and other supply-side efficiencies

8.23 We explored the possibility that route-level economies of scale or other supply-side efficiencies contributed to the limited extent of head-to-head competition in the industry.

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4 Arriva provided a submission to the CC (Oxera (2010), ‘Can Depot Areas And Routes Support Additional Competitors?’ November 2010) which found that the majority of Arriva’s routes could not profitably sustain an extra competitor (see Arriva’s response to provisional findings, paragraphs A13 & B20). Arriva said that ‘the CC’s error was not to take proper account of the importance of market size in offering profitable opportunities to competitors’. We do not agree that our analysis fails to take proper account of market size and demand. For example, the performance-concentration analysis takes these factors into account by including a range of control variables (see, for example, Appendix 7.1, paragraph 154) and uses the instrumental variable technique to account for unobserved demand factors (see Appendix 7.1, paragraphs 29–45). Arriva states ‘...the analysis conducted by Oxera...aims to explain why the economics of the industry suggest that more competition may not be sustainable, which is, in fact, one of the CC’s major findings’ (Response to provisional findings, paragraph B20).
8.24 We considered whether there are route-specific economies of scale that might make it unprofitable for more than one operator to run local bus services (at least on certain routes or in certain areas). Economies of scale exist when the average cost (total cost divided by total output) declines as output increases, usually because there are fixed costs of production. Where economies of scale are substantial relative to demand, this might imply that only one operator can profitably run local bus services, as only one operator will be able to achieve sufficient scale to cover fixed costs.

8.25 Where route-level economies of scale are substantial, we would therefore expect to see a lack of head-to-head competition on low-demand routes but more prevalent on high-demand routes where there is sufficient demand for more than one operator to enjoy route-level economies of scale.

8.26 We have not seen evidence to persuade us that economies of scale are sufficient at the route level to affect the sustainability of head-to-head competition along a route. Even if there were economies of scale at a depot level (see paragraphs 9.174 to 9.187), we would expect these economies to apply only to a group or network of routes. There are no fixed costs which are clearly attached to specific routes.

8.27 Despite this general observation, we considered the possibility that there could be routes where demand is so limited that the route can only support an allocation of a single vehicle. In other words, routes on which it would not be possible to cover the costs of running more than one vehicle. In this case, since only one operator can run a particular vehicle, it may not be possible for a route to support multiple operators.

8.28 We used timetable information in order to assess what proportion of single-operator routes—defined as routes that do not face an overlap of 3.2 km or more from a rival operator—have a timetable such that they could not be served by a single vehicle. Where we can show that a route was served by more than one vehicle, this would indicate that very low demand could not be an explanation for the high degree of concentration that we observe on that route. Where we cannot show that a route was of sufficiently high frequency that they are served by more than one vehicle, we cannot rule out the possibility that demand is so limited that these routes could only support a single operator. However, this does not necessarily mean that the route is incapable of supporting more than one operator (see paragraph 8.31).

8.29 We used information in the Traveline database on the frequency and average scheduled journey time of local bus routes in the reference area in order to identify routes that are very unlikely to be served by a single vehicle. A route was labelled as being very unlikely to be served by a single vehicle if its timetable showed two buses each scheduled to depart from either the same or different ends of that route within the same 15-minute period, but the average scheduled journey time of that route was greater than 15 minutes. Table 8.1 shows the results of our analysis.
### TABLE 8.1 Proportion of routes which are very unlikely to be served by a single vehicle

<table>
<thead>
<tr>
<th>Routes not facing an overlap from a rival operator of</th>
<th>Proportion of these routes which are very unlikely to be served by a single vehicle*</th>
<th>Proportion of these routes, weighted by total weekly services, which are very unlikely to be served by a single vehicle</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.2 km or more</td>
<td>37.7</td>
<td>76.8</td>
</tr>
<tr>
<td>Routes not facing an overlap of 3.2 km or more from a rival route with a regularly† overlapping timetable</td>
<td>48.2</td>
<td>85.4</td>
</tr>
<tr>
<td>All routes</td>
<td>44.0</td>
<td>86.1</td>
</tr>
</tbody>
</table>

Source: CC analysis of Traveline data for October 2009.

*Routes were categorized as being very unlikely to be served by a single vehicle when their scheduled journey time was such that it would not be feasible to maintain the observed frequency of the route with a single vehicle. The average journey time in minutes was used, and so it is possible that in some instances the observed frequency may have been met by a single vehicle if the journey time at that point in the timetable was substantially below the average, although we expect such instances to be rare. Timetable information was only available to the nearest quarter of an hour, and buses were assumed to depart at the maximum possible interval in carrying out this classification exercise. In calculating frequencies, we do not observe which end of the route a departure takes place from. No allowance is made for any break between departures. Given these assumptions, routes which are not classified as being very unlikely to be served by a single vehicle may well still be served by more than one vehicle (and indeed may have timetables that require this).

†Rival routes were categorized as having a regularly overlapping timetable if they operated in 50 per cent of the 3-hour periods in which the primary route operated, and had a frequency of at least 50 per cent of that of the primary route. See Appendix 8.1 for more details.

8.30 Table 8.1 shows that a substantial proportion of single operator routes (37.7 to 48.2 per cent) have a timetable such that they are very unlikely to be served by a single vehicle. Moreover, these routes account for over three-quarters of the total number of services run on all single-operator routes. Given the conservative assumptions employed, we would expect the true proportion of routes that are actually served by more than one vehicle to be considerably higher than this. We therefore found that, at least for a substantial proportion of routes accounting for the great majority of passenger journeys, low demand cannot provide an explanation for the lack of head-to-head competition that we observe.

8.31 Even if demand on a route supports only a single vehicle, it may be possible to use smaller vehicles, or coordinate timetables with the participation of the LTA. In practice, operators may not assign a vehicle to a specific route—instead, they may inter-work two or more routes through the day (see paragraph 8.35).

8.32 Given this, we would expect, in practice, there to be few routes which would only be able to support one vehicle. We conclude that the rarity of head-to-head competition across the reference area cannot be explained by route-level economies of scale.

**Efficiency reasons to maintain frequency in response to head-to-head competition**

8.33 Arriva and FirstGroup both highlighted efficiency reasons why local bus operators might seek to maintain frequency in response to head-to-head competition, thus making it less likely that a route will support more than one operator.

8.34 Arriva told us that it was often not viable for two or more operators to ‘share’ a route because if they operated at different times of the day, this would be unlikely to reduce the number of buses that each operator required to run the services (the PVR would be similar in each peak hour). As a result, engineering and driver costs for an operator would be largely unchanged, unless vehicles and drivers could be deployed on

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5 The circumstances in which LTAs may approve qualifying agreements such as those on timetables is set out in Section 12.
6 FirstGroup argued that this might be the case for low-demand routes only.
other services. It said that a substantial proportion of costs were incurred regardless of whether an operator ran services throughout the day, and therefore they would have incentives to maintain their frequencies at all times of day by making at least a contribution to these fixed costs.

Arriva also said that providing alternate services throughout the day would be very difficult to implement efficiently because of ‘interworking efficiencies’, which arose when a single vehicle was used more efficiently across more than one route, rather than being solely deployed on an individual route. Arriva told us that it was common for an operator to schedule its buses to interwork between two or more routes as this minimized unproductive layover time between trips. A drop in frequency due to enforced route sharing might make interworking impossible since it was limited by other routes’ headways and how round trip times and clock-face times dovetailed with the shared route. Arriva suggested that to achieve these interworking efficiencies, an operator might seek to maintain its frequency following new entry. Similarly, FirstGroup told us that there could be problems with interworking a low-demand route with other services at lower frequencies. FirstGroup told us that low-demand, low-frequency routes were often interworked with other services in an area, and reducing the frequency (due to sharing services on a route) would make this less viable.

FirstGroup gave additional reasons as to why low-demand routes might support only one operator, which similarly suggested that operators might have incentives to maintain their frequencies in response to head-to-head competition. The first of these was scheduling inefficiencies resulting from a mismatch between headways and journey times when operating at lower frequencies. With long gaps between services, FirstGroup told us that it was less likely that the arrival of one service would coordinate well with the next departure which could lead to drivers having to wait a significant amount of time before commencing the next service, which would tend to increase costs.

FirstGroup also said that there would be difficulties achieving a simple and coordinated timetable between two operators on a low-demand route.

These supply-side efficiency reasons might explain in part why, on lower-demand routes, operators maintain frequency in response to head-to-head competition, and hence why most operators argued that, save on particular corridors of heavy demand, head-to-head competition along the length of a route was unsustainable. On particularly frequent services, it is likely that buses will be fully employed on one route and hence any interworking efficiencies are unlikely to apply. Indeed, FirstGroup noted that the efficiencies it discussed were only relevant for low-demand routes.

The impact of operator conduct on head-to-head competition

In this section, we consider whether there is reason to believe that the conduct of operators in this industry might limit the extent of head-to-head competition. We consider whether there are characteristics of the supply of local bus services that can lead to the exit of the incumbent operator or the entrant so that head-to-head competition (and the associated customer benefit) is not sustained over time. We consider

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7 This was in the context of the CC having asked Arriva why, if Arriva has got four services an hour in a particular area, Arriva is running four services an hour rather than Arriva running two and somebody else running two? Arriva understood this to mean that if a route could sustain four services an hour, why are these services likely to be run by one operator rather than two?
8 Arriva told us that interworking efficiencies could be achieved even by smaller operators, operating just a few routes in a network.
9 Even on networks of lower-demand routes, however, we have not been given any explanation as to why it is not possible to arrange interworking to accommodate reduced patronage arising from increased competition.
other aspects of operator conduct later in this section, including geographic market segregation, in paragraphs 8.166 to 8.262 and exclusionary conduct in paragraphs 8.263 to 8.277.

8.40 We first outline the possible explanations for our observation that sustained head-to-head competition is uncommon. We consider economic models which suggest that characteristics of the industry are likely to combine to create an incentive for operators to compete in a particular way. They also explain how acting on those incentives can lead to high levels of concentration. We then explore whether we observe those characteristics arising in the markets that we are considering.

Possible explanations for a lack of sustained head-to-head competition

8.41 The CC commissioned Corelim Consultants to survey economic literature on the structure of local bus services (see Appendix 8.2). The report has been published on the CC’s website.\(^\text{10}\) It shows that economic models generally predict that frequency of service is the key parameter of competition between bus operators. This prediction depends on an underlying assumption that customers are likely to board the first bus that arrives at the bus stop that serves their journey purpose, rather than waiting for a cheaper, cleaner or more comfortable alternative. In other words, when choosing which bus to take, these customers attach little significance to quality differences between the services provided and are insensitive to differences in fares between operators.

8.42 One potential limitation of the models arises from another of the assumptions that generally underpins them—they focus on the purchase of single tickets and the decisions made by consumers when they are at the bus stop. However, our consideration of network effects suggests that there is likely to be a ‘within-route’ effect (see paragraph 8.54) that acts in the same direction on operators’ incentives to compete on frequency and applies to those passengers who plan their journey in advance and purchase single-operator multi-journey tickets.

8.43 The report suggests that the process of head-to-head competition, driven by an incentive to increase frequency, could in some circumstances lead to the creation of excess capacity (ie more buses being run on the route than can attract sufficient revenue to cover costs). This may reduce the profitability of operators and result in their becoming loss-making. An operator will have an incentive to add services, and it will do so as long as the effect is to add more revenue than the increase in costs. Excess capacity can arise as the competing operators would each add extra services because individually these extra services can be timed so as to take revenue from the rival operator’s services (by running shortly ahead of them) and scheduled to maintain or improve the individual operator’s network advantages.

8.44 The report also highlights several contributions to the literature which explain why operators are unlikely to compete on a stable timetable when operating the same route. The incentives to change timetabling to operate just in front of a rival, or to ‘front run’ other operators on the road, could lead to frequent timetable changes, which may reduce customer demand.

8.45 These models are based on an assumption that passengers are evenly distributed over time and suggest that, in the absence of the ability for operators to randomize their timetables (see section 3.3 of the Corelim Report in Appendix 8.2), this could create a cycle where we would observe continual reregistrations of timetables. Even

absent the even distribution of passengers over time, Arriva told us that, given that the number of passengers boarding varied between stops and at different times of day, it was most unlikely that ‘sharing’ services throughout the day would split the revenue equally. It was even possible that such ‘sharing’ would give rise to the previous practices of the ‘bus wars’ when operators raced to the stops to ‘hoover’ up the passengers, possibly ignoring passengers at the less busy stops to gather in those at the busier stops.

8.46 We reach two important conclusions from the theoretical literature. First, taking both the potential for overcapacity and for frequent timetable changes, the nature of incentives in the provision of local bus services may be such that routes will tend not to support closely-competing multiple operators. Generally speaking, this will lead to pressure on one or other of the bus companies serving a multiple operator route to exit. This would also apply where different routes overlap substantially. Second, if operators anticipate that the route could eventually be operated profitably only by a single operator, each will be incentivized to try to ensure that the other operator is the one who is forced to exit. This can be done by trying to raise costs or decrease revenues for the rival, for example by increasing the number of services run, or by competing on other dimensions such as lowering fares.

8.47 There are two further characteristics of the bus industry that, in combination, further increase the likelihood of an incumbent responding to entry in such a way as to risk an unsustainable outcome. First, the inherent transparency of the market means that operators can easily detect when a rival has launched a competing service. Second, the nature of the industry means that they find it easy to target a response—rather than having to respond across a whole network, operators can limit a frequency or fare change to a particular route that faces competition, thereby reducing the cost of responding.

8.48 In the following paragraphs, we explore whether these incentives exist in practice. We discuss in turn:

- customer behaviour (paragraphs 8.49 and 8.50);
- within-route network and ticketing effects (paragraphs 8.51 to 8.56);
- transparency (paragraphs 8.57 and 8.58); and
- ability to target competitive activity (paragraphs 8.59 and 8.60).

**Customer behaviour**

8.49 The model of competition in paragraphs 8.39 to 8.48 concentrates on the incentives to compete given a tendency for bus passengers to be relatively insensitive to fares and quality differences and so catch the first bus that arrives. As noted in paragraphs 5.33 to 5.41, we found that a substantial proportion of customers plan the bus they are going to use in advance and that customers switch between operators at the planning stage of the trip based on a number of attributes of operators’ offerings. However, for single/return/day ticket customers, once at the bus stop these attributes are largely overridden by a bus being first to arrive: 57 per cent of these ticket holders for which we have information chose the operator that they used because it was first to arrive. This is consistent with evidence from Arriva, FirstGroup, Go-Ahead and National Express outlined in paragraph 5.33, and is consistent with customers wishing to minimize the cost of waiting.
8.50 For customers who plan their journey in advance and do not change their mind at the bus stop, service frequency can still be a factor which can influence the choice of operator, because of ticketing and network effects, which are explained in the next section.

Network and ticketing effects

8.51 Network effects might influence the incentive of bus companies in terms of how best they attract those passengers who are interested in buying multi-journey tickets. As shown in paragraphs 5.53 to 5.62, many customers purchase operator-specific season or network tickets, or return tickets. They are incentivized to do this because these tickets are usually sold at a discount to single tickets if the passenger is likely to make multiple trips (see paragraph 5.54). This changes the trade-offs faced by the passenger regarding the use of a particular operator’s services for subsequent journeys—they have already paid for one operator’s services and will have to pay extra to use a rival operator’s services. Concessionary passengers and those who purchase single tickets will not be influenced in their choice of operator in the same way, as they do not financially commit themselves to a particular operator’s service in advance of arriving at the bus stop.

8.52 Positive network effects arise when the utility a consumer derives from consumption of a good increases with the number of other people consuming the good. In relation to local bus services, these effects are likely to apply indirectly—the more users there are, the more services operators will provide and hence the more valuable is an individual journey to an individual user, as, for example, waiting time is reduced. When considering possible effects arising from the range of routes provided by an individual operator, Arriva, FirstGroup, Go-Ahead and Stagecoach told us that local bus services were not characterized by (across-route) network effects, although National Express told us that the areas in which it operated were characterized by network effects.

8.53 In relation to return and season tickets, we consider that a network effect occurs when an individual bus consumer makes multiple uses of a bus operator’s services (for example, at different times of day). More precisely, when customers purchase return or season tickets, they are able to access complementary services offered by local bus operators (such as return journeys or other routes in the local area, where, for example, the utility a consumer derives from the outward leg of a journey increases if the consumer is also able to make a return trip and so the two trips are complementary) and this increases the utility a customer derives from these tickets. Operators’ multi-journey tickets are therefore more valuable the more complementary services they offer and it is in this way that network effects might apply to this industry.

8.54 These network effects on return and season tickets might arise at two levels in the local bus industry. First, on a given route, customers using return or season tickets benefit, to a greater extent than do single-journey ticket holders, from a single operator having a more frequent and comprehensive service, as, at a given price, it offers them greater options, flexibility and reduced waiting times for their overall

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11 Katz and Shapiro, 1985, Network Externalities, Competition and Compatibility.
12 FirstGroup, Arriva, Go-Ahead, Stagecoach and National Express.
13 We note that single-ticket and concessionary passengers will also benefit from positive network effects, in so far as they lead to more services being provided. However, these passengers will not benefit from operator-specific network effects in the way that passengers with single-operator multi-journey tickets do.
14 By comprehensive, we mean the comprehensiveness of the timetable, for example including more evening and weekend services.
journey. These effects satisfy the definition discussed in paragraph 8.52, even though they do not depend on the network or number of routes in an area—we call them ‘within-route effects’. We note that these within-route effects apply to return tickets in the same way as they apply to season tickets, since these effects might apply whenever a customer purchases a ticket that allows a return trip on an individual route. We consider that, where present, these ‘within-route’ effects are likely to provide an incentive to maintain or increase frequency in response to head-to-head competition. They might also provide an incentive for an entrant to come in with a greater frequency of service than would otherwise be the case. For both incumbent and entrant, this is because (all else equal) an operator with greater frequency of service is more likely to win the custom of those passengers who plan their journey in advance of arrival at the bus stop and purchase a single-operator multi-journey ticket.

8.55 Second, if customers using season tickets travel on more than one bus route, they are likely to benefit from an operator having more routes in an area, as more of the journeys they wish to make can be completed using that operator’s season ticket. Such customers are likely, all else being equal, to prefer a season ticket offered by an operator with more bus routes in the area. These effects can be termed ‘between-route network effects’. Although, as discussed in Section 9, these effects are important in our assessment of barriers to entry, we have seen no evidence to suggest that they provide an incentive for operators to maintain or increase frequency in response to head-to-head competition. As a result, we do not discuss them further here, although we discuss them further in Section 9 as part of our assessment of barriers to entry and expansion.

8.56 As shown in paragraphs 5.53 to 5.62, a substantial proportion of customers purchase operator-specific return or season tickets, for which frequency and comprehensiveness of service on the route(s) used is likely to be an important characteristic. Furthermore, for those travelling on season tickets (including day tickets), the large majority take two journeys per day (see paragraph 5.54), suggesting that they make return trips and that, again, frequency and/or comprehensiveness of service on a specific route will be important when deciding to purchase such tickets. Therefore, network and ticketing effects create an additional incentive for bus operators to compete on the frequency and comprehensiveness of the service that they provide.

Transparency

8.57 The nature of the bus industry is such that it is very easy for an operator to observe where a rival is operating and the nature of those rival services. Indeed, the requirement for registration of new services with the Traffic Commissioner (see paragraphs 12.39 to 12.42) means that, for all but the modification of existing frequent services, an operator will have advance notice of the actions of its rivals. Operators’ operational reports and internal documents contain ongoing monitoring of other operators’ service registrations (see paragraph 6.58).

8.58 We find that the level of transparency, in combination with the ability to target competitive activity, makes it more likely that operators will fight against entry (see paragraph 8.47).

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15 This is not to preclude the possibility that passengers make return journeys on different routes over the course of a week/month (perhaps for different journey purposes).
As set out in paragraph 8.47, the nature of bus services is such that operators can easily target any competitive activity. They can alter the frequency on a given route without having to change their offering on other parts of their network (see, for example, Appendix 6.1, paragraphs 58 and 63 to 68). Similarly, they can offer route-specific promotions or use differentiated pricing (see Appendix 6.1, paragraphs 38 to 49). There are also examples of operators using different types of vehicles on different parts of their network, with different buses used on the routes that face direct competition (see, for example, paragraphs 6.46 and 6.56).

This ability to target competitive activity means that the cost of responding is only incurred on the specific route(s), rather than across the whole network. This makes it much more likely that an incumbent operator will respond to entry by a rival and that any response will be stronger. Similarly, potential entrants will be aware of the ability of the incumbent to focus any response.

In paragraphs 8.41 to 8.66, we found that certain characteristics of the bus industry provide an incentive for bus operators to compete on frequency where they face direct competition from a rival. We also found that operators might engage in conduct that makes it less likely that head-to-head competition is sustained in the longer run. In this section, we examine the evidence that operators behave this way in practice.

Instances of competitive behaviour are reviewed in Section 6. We found that when operators enter a service on an established route, the incumbent operator will rarely react by decreasing the frequency of its own services—see paragraphs 6.128 to 6.142. In paragraph 6.124, we also present evidence on instances where Large and Mid-Sized Operators have increased capacity on a route in response to competition. For those instances where we have information, the large majority were in response to a competitor launching a new service or increasing frequency on a route.

Further evidence that competition can lead to an increase in frequency is set out in our performance-concentration analysis—see paragraphs 7.35 to 7.37. This analysis found that greater competition at a route and area level leads to an increase in services run. This is likely to be partly a result of greater frequency of service, but may also be due to longer hours of operation or, at the local area level, extra routes being operated.

In some instances, competition between rival operators has led to ‘overbussing’ or an unsustainable level of competition. Such instances are sometimes known as ‘bus wars’. In Appendix 6.1, paragraphs 59 to 68, we set out the evidence on what prompted Large and Mid-Sized Non-Municipal Operators’ most substantial frequency increases in the year to spring 2010. Several of these occurred in response to head-to-head competition, including, for example, FirstGroup [33] (see Appendix 6.1, paragraph 63).

In paragraph 6.124, we discuss evidence from Large and Mid-Sized Operators’ responses to our written questionnaire about instances where they responded to competition by increasing capacity on a route. We found that 11 of the 48 events

16 In paragraph 6.132, we refer to one instance where Arriva reduced the frequency in response to entry by another operator, but this instance seems to have been highly unusual.
17 ie those examples that were not simply recorded as ‘head-to-head competition’.
discussed had resulted in the exit of at least one operator, but we note that this will be a lower bound on the number of these events that eventually resulted in exit because of the small sample of responses for which we have information and because we observe only a snapshot rather than the result of competition over time (see paragraph 6.126).

**Characteristics of routes where we observe head-to-head competition**

8.66 Despite the characteristics of the local bus industry described in paragraph 8.48 that limit sustained head-to-head competition, we observe instances where some head-to-head competition occurs and is sustained over time. In these situations there usually seems to be one of the following:

- an element of differentiation between the services provided by the competing operators (in terms of geography (i.e. the overlap is only partial), time of service, customer group targeted, etc);
- a sufficiently high level of demand along a route for more than one operator to be able to run a frequent service;
- an element of timetable coordination; or
- accommodation of a non-threatening rival.

8.67 Alternatively, although we observe head-to-head competition when we take a snapshot at a particular point in time, there are some cases where this seems unlikely to be sustainable in the longer run. We discuss each of these situations in paragraphs 8.76 to 8.81.

**Differentiation of offering**

8.68 By its nature, differentiation will lead bus operators to target different groups of customers. This will limit the extent of competition between those operators, relative to the situation where no such differentiation exists. Differentiation can take place on a range of dimensions, discussed in the following paragraphs.

8.69 Go-Ahead told us that when operators entered against its services, it would assess the requirement for a response on a case by case basis—if, for example, the entrant has identified a genuine gap, Go-Ahead would seek to improve its offering to compete more effectively. In other cases, where an entrant sought to differentiate its offering and serve a different demographic, Go-Ahead told us that it might not respond other than by maintaining its offering.

8.70 One example of differentiation is on routes with high student populations, where some operators will offer a lower-price student alternative (such as The Big Lemon in Brighton). Furthermore, as set out in paragraph 6.35, we observe some examples where Large and Mid-Sized Operators have segmented the market to target their services at non-users. This involved operators differentiating their services in terms of quality, fares and/or journey time. For example, in Oxford the evidence suggests that Stagecoach and Go-Ahead compete in terms of quality (see Appendix 6.4—Oxford, paragraphs 35 and 36) and we have seen examples of Small Operators seeking to differentiate their service from larger operators (see paragraph 6.104(e)). We have also seen some operators differentiating by offering an express service (Appendix 6.4—Nottingham, paragraph 71). In some cases operators may differentiate their own services by operating more than one type of service. For example,
Stagecoach operates ‘Magic Bus’ branded services in addition to Stagecoach branded services.

Geographic differentiation

8.71 The most common way in which operators differentiate their offering by geography is by running services from/to different origins and destinations. As mentioned above, we very rarely observe complete overlap of operators’ services; partial overlap is far more common. We find that head-to-head competition where there is a relatively limited degree of overlap can be sustained, for example in Devon (see Appendix 6.4—Devon, paragraphs 26 to 38).

8.72 Examples of partial overlap include situations where two operators’ routes come from different suburbs but overlap on the final corridor into a city centre, or where one operator runs an inter-urban service and the final portion of this route overlaps with another operator’s intra-urban route. In some instances, this overlap will be an incidental consequence of two routes needing to share the same road, on the way into a city centre, for example. But it can also lead to substantial overlaps in terms of customer choice. For example, Stagecoach told us of contrasting experiences of the relationship between inter-urban and intra-urban services in Cardiff (see Appendix 6.4—Cardiff, paragraphs 27 and 61 to 63) and Tyneside (see Appendix 6.4—Tyneside, paragraphs 123 and 124).

8.73 The incentive for operators to ‘over-bus’ when the overlap is only over a limited proportion of their route is likely to be lower, since the gain from overbussing in terms of winning business from a rival will be smaller whereas the costs of this strategy will be borne on the whole route.\(^{18}\) Similarly, since scheduled arrivals are likely to be driven to some extent by those parts of the routes where operators do not overlap, the incentive to engage in front-running (see paragraph 8.44) is likely to be smaller when the overlap is limited.

8.74 We found that, whilst competition may be more likely to be sustained on more differentiated routes, the incentive to compete on other aspects of the competitive offering, such as prices, is also likely to be weakened, where operators compete on a smaller proportion of the route. We have also seen instances where operators are able to price discriminate between customers on the portion of the route that does not face head-to-head competition, and those on the portion of the route that overlaps with another operator.\(^{19}\)

8.75 Examples of sustained head-to-head competition through geographic or other forms of differentiation are more common than ‘high-demand’ routes. However, we note that competition is less vigorous on routes subject to partial overlap and consequently we would expect less favourable outcomes for consumers. Absent the factors set out in paragraph 8.48, which limit sustainable head-to-head competition, we would expect that head-to-head competition would be sustainable at lower levels of geographic or product differentiation.

\(^{18}\) If a small overlap (in terms of miles) contains the vast majority of passenger journeys, this will nonetheless be an important driver of operators’ conduct on the overlap routes.

\(^{19}\) For example, Stagecoach told us that since FirstGroup’s Hampshire and Dorset operating company was the main operator on certain sections of its route in Hampshire and Dorset, it offered reduced prices to take into account this head-to-head competition (see Appendix 6.1, paragraph 39(c)) and FirstGroup offers a lower-priced day ticket in the central Edinburgh zone where it overlaps with Lothian Buses: [www.firstgroup.com/ukbus/scotland_east/tickets/firstday/](http://www.firstgroup.com/ukbus/scotland_east/tickets/firstday/).
High demand

8.76 We found that on some very high-demand routes, more than one operator is able to run a 'frequent' service. Customer flows at bus stops (and hence operators' arrivals on such routes) are sufficiently frequent to remove any incentive to engage in tactics aimed at ensuring that a particular operator arrives before its rivals at the bus stop. Examples of this situation include a route in Manchester (served by 41, 42, 43, 142 and 143 buses) and the 50 route in Birmingham, which we understand is the highest-frequency route in the city and along which National Express and Rotala compete. It is also likely that passengers will be less concerned about catching the first bus to arrive in such circumstances, as waiting times for subsequent buses are likely to be short.

8.77 We find that on routes of this type, extensive head-to-head competition is sustainable over time. However, routes of this type are currently rare (see paragraph 12.43). Absent the factors set out in paragraph 8.48, which limit sustainable head-to-head competition, we would expect head-to-head competition to be sustainable at lower levels of demand than is currently the case.

Timetable coordination

8.78 One way in which sustained head-to-head competition might arise is through operators reaching some degree of timetable coordination subject to the relevant competition tests being satisfied. For example, in Merseyside a Statutory Quality Partnership has been introduced that regulates service frequency, but which parties tell us allows competition on non-frequency variables to continue (see Appendix 12.2). This sort of timetable coordination might also be initiated by the LTA. We note that such examples are relatively rare.

Accommodation of smaller operators

8.79 Overlap on the length of a route by a smaller operator with a lower-frequency (and possibly lower-quality) service appears, at least sometimes, to be accommodated by a larger incumbent operator (in this context, the term 'larger' refers to its presence and commitment on the route). It appears that such operators do not add so much overall frequency to a route so as to make it unsustainable, and the revenue such smaller operators take from larger operators is unlikely to be sufficient to trigger a response in terms of increasing frequency. For example, see paragraph 6.136, where we discuss FirstGroup’s response to entry by different operators. In addition, Stagecoach told us that in 88 out of 118 instances of entry against its services it did not respond (see paragraph 6.140).

8.80 We note that smaller operators in a route, as described in paragraph 8.79, are unlikely to provide much of a competitive constraint on the incumbent operator on a route and may not be classified as effective head-to-head competition using the methodology set out in Appendix 8.1. However, absent the factors set out in paragraph 8.48 which limit sustainable head-to-head competition, we would expect smaller operators to be able to expand their services, and become an effective competitor on a route, more easily.

Short-run disequilibrium

8.81 We sometimes observe two operators on a route which compete head-to-head for a short period, but it is an example of opportunistic entry that subsequently fails because the entrant has misjudged the level of unmet demand and the revenue
available to it (see, for example, the discussion of RH Transport in Oxford in para-
graph 6.139(e)). In other cases, an incumbent may not be able to remain on the route
in the long term. For example, Arriva told us that it withdrew from Grays in 2006,
following the entry of Ensign Bus. Arriva told us that a number of frequency and ser-
vice improvements implemented by both operators proved to be unsustainable, and
that it took the decision to withdraw.

Why we might observe fewer ‘bus wars’ than in the past

8.82 In paragraphs 8.41 to 8.47, we explained that operators may have an incentive to
compete in such a way as to lead to frequent timetable changes and front-running.
However, as summarized in paragraph 6.143, frequent reregistrations of service
timetables do not now appear to be a common characteristic of competition, particu-
larly in comparison with the years immediately after privatization. 20 Racing other
operators, to cut in front of them at the busiest stops, also does not appear to be as
prevalent as in the years immediately after privatization.

8.83 Bus operators might have less incentive to engage in frequent timetable changes in
an attempt to win custom from their rivals for several reasons. In part, this is a natural
consequence of the characteristics described in paragraph 8.48. Following privatiz-
ation, we would expect that head-to-head competition would wither on routes where
customer behaviour, network effects, transparency and operators’ ability to target
responses make head-to-head competition unsustainable. In subsequent years, we
would also expect few instances of new entry on to routes where this has happened.

8.84 In some cases Traffic Commissioners have imposed financial penalties if operators
do not meet their punctuality requirements (see paragraphs 2.65 and 6.42). Traffic
Commissioners may also intervene in cases of leapfrogging where this is likely to
raise dangers for road users. We have seen a few examples where Traffic
Commissioners have imposed licence restrictions or traffic conditions in response to
periods of frequent timetable changes or overbussing (for example, in Glasgow a
licence restriction was imposed on FirstGroup following a period of competition
between FirstGroup and McKindless).

8.85 In addition, operators may have seen the potentially detrimental impact on demand of
frequent timetable changes and have decided to engage in head-running, leapfrog-
ging and other similar behaviours less readily.

Competition on price and other aspects of the offer

8.86 Operators also compete on aspects of their service other than frequency (see para-
graphs 6.49 to 6.61). This is likely to be because, where customers face a choice,
they might decide which service to catch, or which operator’s network ticket to buy,
before they get to the bus stop (as outlined in paragraph 8.92).

8.87 We find that ongoing head-to-head competition can have an impact on operators’
pricing, and that operators monitor each other’s prices. As noted in paragraphs 6.130
to 6.142, reductions in price are also a common response by operators to entry. The
qualitative evidence shows that operators sometimes respond to entry by reducing
single fares on certain routes where they face a significant degree of head-to-head
competition. It also shows that there is sometimes price competition over the pricing
of an area and period tickets. We also found that operators responded to entry by

20 See, for example, Commons Select Committee on Transport, Local Bus Deregulation, HMSO, 1995.
improving ‘service quality’ by introducing new vehicles, improving punctuality or reviewing and modifying the network of routes offered in an area. In some instances, an improvement in service quality in response to head-to-head competition appears to be part of an operator’s strategy to differentiate its services, and thereby sustain a presence on the route.

8.88 The CC’s customer survey also explored how customers responded to relative price changes between two operators on urban competitive corridors. The survey results indicated that on urban competitive corridors, the cross-price elasticity between operators is 1.6, 21 suggesting that customers have a high propensity to switch between operators in response to changes in operators’ relative prices. As noted in Section 5, customers are more likely to respond to relative price differences when planning a trip (as opposed to at the bus stop); so they may plan to catch the bus of the lower-priced operator. The results are less likely to apply to customers making a decision on what bus to take at the bus stop—see paragraphs 5.33 to 5.41—where arrival times of operators are likely to override relative differences in price (or quality) for single ticket and concessionary users.

8.89 Price reductions in response to head-to-head competition have in some instances been substantial. For example, in Appendix 6.1 we set out Large and Mid-Sized Non-Municipal Operators’ most substantial price cuts in the year to spring 2010, many of which were in response to head-to-head competition or new entry (see Appendix 6.1, paragraphs 33 to 37). In addition, some of our case studies discussed substantial price responses to entry (see, for example, the response to Premier Travel’s entry by Trent Barton (a subsidiary of Wellglade Ltd) in Nottingham (see Appendix 6.4—Nottingham, paragraphs 76 to 82) and FirstGroup response to Norfolk Green entry in King’s Lynn (see Appendix 6.4—Norfolk, paragraphs 47 to 63)).

8.90 Passenger willingness to switch in response to the relative cleanliness, reliability and seat availability of rival operators, at the planning stage of their trip, was also analysed in the CC’s customer survey (see paragraphs 5.26 and 5.27). The survey results show that at the planning stage these factors are also important, although this is difficult to quantify.

8.91 In addition, operators have incentives to compete only on non-price factors, in particular frequencies, for concessionary fares passengers as these passengers do not pay for most of their journeys.

8.92 Overall we find that a proportion of customers (see paragraph 5.41) plan their trip in advance and in doing so are more likely to respond to relative differences between operators’ prices and service quality. This will provide incentives for operators to compete on these price and service quality aspects of the offering, and to differentiate their services. The incentives to compete on these factors are dampened by the willingness of single and concessionary passengers to board the first bus that arrives once they are at the bus stop (see paragraphs 5.33 to 5.41), but in so far as competition on the pricing of network tickets persuades people to make a choice ahead of getting to the bus stop, it can reduce the incentives to front run.

**Conclusions on head-to-head competition**

8.93 We can make a number of conclusions about the nature of head-to-head competition.

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21 In other words, a 10 per cent increase in one operator’s prices will lead to a 16 per cent increase in a directly competing operator’s passengers, all else equal.
First, for the reasons set out in paragraphs 8.7 and 8.8, we find that head-to-head competition, where present, delivers significant benefits to customers. However, as set out in Appendix 8.1, we find that head-to-head competition is uncommon.

We examined the reasons for the lack of head-to-head competition that we observe across the reference area.

We found that a lack of demand did not explain the scarcity of head-to-head competition. We have not identified any route-level economies of scale and the evidence suggests that only a small number of single-operator routes are served by only one vehicle.

We found that in general (subject to some exceptions discussed in paragraphs 8.86 to 8.92), when bus operators compete head-to-head they do so at least in part on the basis of service frequency. Moreover, any competitive actions can be focused on a particular route, without having to spill over into the operator’s other services in an area.

As a result, head-to-head competition can be unsustainable in that it will result in a costly period of rivalry between operators which is likely to be loss-making and so culminate in the exit of one operator. This occurs because operators both have an incentive to increase the number of services to attract more passengers from their rivals, and have an ability to target activity where they face competition so as to increase the likelihood of their own survival and the exit of the competitor.

This is facilitated by the following aspects of the industry which together restrict the extent of head-to-head competition:

- consumer behaviour (tendency to board the first bus that arrives at the bus stop unless purchased ticket in advance);
- within-route network and ticketing effects;
- transparency within the industry as to where services are operated; and
- the ease with which operators can target competitive activity.

Head-to-head competition tends to be less sustainable, the closer the competition between operators becomes. Therefore, operators generally avoid replicating each other’s routes and largely avoid the sort of competition set out in paragraph 8.98. To the extent that we observe sustained head-to-head competition, the services provided by rival operators are often differentiated in some way. Other possibilities include:

- when there is a sufficiently high level of demand along a route to support multiple operators providing a service with a high frequency; or
- some element of timetable coordination; or
- accommodation of a non-threatening rival.

In the absence of the characteristics set out in paragraph 8.99, we would expect a higher incidence of head-to-head competition. This is because head-to-head competition would become sustainable at lower levels of demand and lower levels of product or geographic differentiation. In addition, we would expect that smaller rivals
would be able to expand and offer a greater competitive constraint on incumbent operators without triggering unsustainable competition.

8.102 In addition to the characteristics set out in paragraph 8.101, head-to-head competition may be affected by geographic market segregation. We discuss the extent to which geographic market segregation has restricted the degree of head-to-head competition in paragraphs 8.166 to 8.262.

The constraint from potential competition and new entry

8.103 In this section, we explain how operators that do not compete head-to-head on a route might provide a competitive constraint on the current behaviour of incumbent local bus operators.

8.104 We distinguish two categories of prospective competitor. We define those operators with existing services and facilities nearby as ‘potential competitors’. We refer to the constraint on incumbent operators as a result of the threat that potential competitors might switch or expand their existing services and set up directly competing services as ‘potential competition’. We define those operators without existing services and facilities nearby as ‘new entrants’ and we define the constraint on incumbent operators’ current behaviour as a result of the threat that new entrants might set up directly competing services as ‘the constraint from new entry’. We refer to the setting up of directly competing services, by either a potential competitor or a new entrant, as ‘entry’.

8.105 We discuss the extent to which potential competition acts as a constraint on bus operators in paragraphs 8.118 to 8.136 and the extent to which new entry acts as a constraint on bus operators in paragraphs 8.137 to 8.152. We discuss actual entry and expansion in paragraphs 8.153 to 8.160. First, however, we discuss why, in principle, potential competition and new entry might provide a constraint (see paragraphs 8.106 to 8.117).

Why might incumbent operators be constrained by potential competition and new entry?

8.106 In this section, we discuss why incumbent operators might have incentives to offer passengers a better and cheaper\textsuperscript{22} local bus service where there is a threat of another operator setting up a directly competing service (a threat of entry). In particular, we explain why the prospect of entry might cause an incumbent operator to take actions in advance of any actual entry and moderate its current behaviour (rather than simply responding to competition when it happens).\textsuperscript{23,24}

8.107 Economic theory provides a number of explanations of why firms might take actions in advance of entry. However, it is important to note that potential competition will only provide a constraint under certain conditions. First of all, the incumbent firm must be able to influence the likelihood of entry through its actions. For example, the incumbent may be able to commit in advance to ‘tough’\textsuperscript{25} action in the event of entry.

\textsuperscript{22} For example, by charging a fare below the level that would maximize its current profit.

\textsuperscript{23} In other words, we explain why it might be profitable overall for an incumbent operator deliberately to sacrifice some profit pre-entry.

\textsuperscript{24} In the remainder of this section, we use ‘prices’ as shorthand for the overall value to the consumer of the competitive offer. A reduction in prices is therefore shorthand for an improvement in any component of the competitive offer including improvements in frequency, quality of service etc.

\textsuperscript{25} This is a term used in the economic literature to refer to behaviour that would render entry unprofitable. For example, in Dixit (1981) the incumbent commits to ‘tough’ action in the event of entry by investing in machinery that lowers its marginal costs.
which would render entry unprofitable. Alternatively, if there is some uncertainty over the incumbent’s costs of operation, an incumbent firm may be able to use low prices to signal that entry would not be profitable. Second, the action in question must be profitable for the incumbent. If committing to ‘tough’ action or attempting to signal in advance of entry (a deterrence strategy) is less profitable than a strategy of allowing entry (an accommodation strategy), incumbent firms will not undertake those actions and will not be competitively constrained in advance of entry. An accommodation strategy indicates that the incumbent will respond to entry only after it has happened. Its choice of response may then vary from passive acceptance through to active competitive responses and even to extreme responses which might be intended to create a reputation for retaliation in order to create a strategic barrier to future entry.

8.108 The possibility of new entry and potential competition acting as a constraint on incumbent firms, and the strength of that constraint, depends in part on the scale of any entry barriers—see Section 9. Where entry barriers are very high, the incumbent firm’s monopoly prices and output may not be sufficient to induce entry, and there would be no need for firms to take anticipatory actions. Where entry barriers are very low, it is likely to be more difficult and costly for the incumbent to influence entry, and incumbent firms are more likely to find an accommodation strategy more profitable.

8.109 In addition, within these two extremes, the scale of entry barriers will affect the strength of constraint from potential competition. Lower entry barriers will increase the scale of the action needed (such as a price cut) to deter entry and consequently the constraint from potential competition is likely to be stronger. Where entry barriers are higher (but not so high as to preclude the possibility of a constraint from potential competition), the size of the price cut necessary to deter entry will be lower and consequently the constraint from potential competition is likely to be weaker.

8.110 Another important factor in determining whether an incumbent is more likely to seek to deter rather than accommodate entry is the likely nature of post-entry competition. Where post-entry competition is likely to be more vigorous, the profitability of an accommodation strategy is likely to be lower. For a given level of other entry barriers, a deterrence strategy is therefore more likely where post-entry competition is likely to be more vigorous.

How might potential competition and new entry affect incumbent local bus operators?

8.111 We consider two factors to assess the likelihood, in principle, that potential competition or new entry is a constraint on the behaviour of incumbent local bus operators: first, how bus operators could influence the likelihood of entry, and second, how profitable a strategy of this type is likely to be compared with the alternative strategy of responding to competition when it occurs.

8.112 We identified two ways in which incumbent bus operators might be able, in principle, to influence the likelihood or scale of entry. In general, incumbent local bus operators cannot credibly commit to ‘tough’ action in the event of entry, as most of the assets

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26 See Bain (1968) and Dixit (1981) for examples of models in which commitment can provide incentives for pre-entry price restraint.
27 The term signalling denotes any action taken to indirectly communicate certain attributes such as low costs or high quality which are not observable by rivals (or customers). See Milgrom and Roberts (1982a) and Fudenberg and Tirole (1986b) for examples of how asymmetric information can lead to incentives for pre-entry price restraint.
28 Although, as discussed in paragraphs 9.58 to 9.65, operators may affect the level of entry barriers by engaging in strategic behaviour.
involved are not specific to that local area. However, bus operators may be able to commit to post-entry behaviour by lowering the prices of network tickets and increasing the quality of their network. This may have two effects: first of all, as discussed in paragraphs 9.66 to 9.127, stronger network effects will make entry more difficult, and second, larger network effects provide incentives for incumbent firms to respond to competition differently, as discussed in paragraphs 8.51 to 8.56. Potential competition or the threat of new entry may therefore give incumbent operators an additional incentive to discount network tickets in order credibly to commit to a ‘tougher’ response to entry. In addition, there may be some uncertainty over the costs of an incumbent operator on a particular route or in a particular area. In principle, the incumbent local bus operator may be able to deter entry by offering low fares in an attempt to convince an entrant that there is no profitable opportunity for entry.

8.113 As discussed in paragraph 8.108, the likely profitability of a strategy for entry deterrence is affected by the level of barriers to entry. Where entry barriers are sufficiently high, a deterrence strategy is unnecessary, and where barriers are very low, an accommodation strategy may be the more profitable strategy. Our findings in Section 9 suggest that barriers to entry, and hence the constraint from potential competition and new entry, vary between areas.

8.114 These findings suggest that the constraint on incumbents from potential competition and new entry is strongest where:

- there is a potential entrant with existing services and facilities nearby;
- where that entrant is a financially strong relative to the incumbent;
- where, in the case of potential competition, the extent of the potential entrant’s existing services is sufficient to confer a similar network advantage to that enjoyed by the incumbent operator; and
- where area-specific barriers to entry are low.

8.115 We discuss the nature of head-to-head competition in paragraphs 8.3 to 8.100. We find that in general there are limited ‘market expansion’ effects and relatively large ‘business stealing’ effects (see paragraph 8.6), and that there are also factors which give operators incentives to increase frequency on a route in response to head-to-head competition (see paragraphs 8.41 to 8.43). As a consequence, competition between bus operators is often vigorous. We also find a tendency for head-to-head competition between operators not to be sustained (see paragraphs 8.48 to 8.60), leading to a possibility that an incumbent operator might be displaced by an entrant. These features of head-to-head competition suggest that a deterrence strategy is likely to be more profitable than an accommodation strategy in many cases.

8.116 However, we also note that head-to-head competition is sometimes differentiated with operators targeting different groups of customers (see paragraphs 8.68 to 8.75). This differentiation can limit the extent of competition between operators. It may therefore be more profitable to accommodate, rather than deter, entry where the entrant is likely to offer a differentiated service.

29 For example, buses can be redeployed to other routes or other local areas. Any attempt by the operator to signal that it will be ‘tough’ in the event of entry are unlikely to be regarded by the entrant as credible because once entry happens the more profitable strategy will be to optimize its service and redeploy the buses elsewhere.

30 The costs to the incumbent of offering discounts to increase network ticket sales and consequently the strength of network externalities are sunk and cannot be recovered. As a consequence, the commitment to post-entry behaviour would be credible as it has changed the incumbent’s post-entry optimum strategy.
In principle, incumbent operators could influence the likelihood or scale of entry and, at least in some instances, a deterrence strategy may be more profitable than accommodation. Potential competition and new entry may therefore act as a constraint on incumbent operators. However, the strength of that constraint is likely to vary from area to area because of variation in the identity, geographic location and scale of potential entrants in comparison with the incumbent, variation in area-specific barriers to entry and variation in the likely nature of post-entry competition.

Evidence regarding the extent to which incumbent operators are constrained by potential competition

We assessed the impact of potential entry on the behaviour of incumbent local bus operators in practice. We looked at four sources of evidence regarding the constraint from potential competition: shares of supply, the views of operators on the constraint they face from potential competition, evidence from the operators’ internal documents and finally evidence from our performance-concentration analysis.

Shares of supply within Urban Areas and in the area around Urban Areas

The shares of supply of the largest operators in an Urban Area are discussed in Section 4 (see Appendix 4.3 for a complete schedule of shares of supply by Urban Area). These measures are useful for giving a broad indication of the relative share of journeys carried by different operators in a town. This measure provides high-level information about the extent to which relevant markets in the Urban Area are likely to face competition.

In particular, shares of supply can convey some information about the likelihood that individual flows in the Urban Area will face head-to-head competition. The greater the proportion of services accounted for by the largest operator in an Urban Area, the lower the likelihood that flows in that area will face head-to-head competition from other operators. In addition, all else equal, an Urban Area with a greater share of supply accounted for by operators other than the largest operator are likely to face a stronger constraint from potential competition. Also, the strength and identity of the potential competitor will affect the constraint from potential competition. Where small operators have been acquired by a large or mid-sized rival, we have seen nearby operators perceive them to be a greater threat (see paragraphs 6.60 to 6.70).

We can use shares of supply to illustrate the different ‘kinds’ of area that exist (‘near monopoly’, ‘near duopoly’ and ‘other’ areas), allowing a better understanding of the different local bus market structures that are observed in different local areas.

As set out in paragraphs 4.11 to 4.33, Urban Areas are, on average, highly concentrated, with only a small number of operators with significant shares of supply. For example, looking across the Urban Areas, the largest operator runs, on average, 69 per cent of local bus services on all routes in an area. The largest operator in an Urban Area has a share of supply of above 90 per cent in 32 Urban Areas (13 per cent of all areas), above 80 per cent in 66 Urban Areas (28 per cent of all areas) and above 75 per cent in 92 Urban Areas (38 per cent of all areas).

In areas where operators engage in geographic market segregation (see paragraphs 8.166 to 8.262), the relationship between shares of supply and the strength of the

31 In extremis, an Urban Area with a 100 per cent share of services accounted for by the largest operator will have no head-to-head competition at all.
constraint from potential competition will not be straightforward and consequently shares of supply may not provide a useful guide.

8.124 If potential competition constrains operators’ behaviour, the existence of operators with substantial networks in the area surrounding an Urban Area might also be relevant in determining the extent of competition in the local bus industry. For this reason, we also considered concentration in the areas surrounding each Urban Area. More specifically, we considered a 12 km area around each Urban Area, and then calculated the proportion of all weekly bus services run by each operator on all routes which cover a distance of at least 500 metres within this boundary (and inside the Urban Area). Table 8.2 shows some descriptive statistics about the number of operators and extent of concentration in these wider areas.

<table>
<thead>
<tr>
<th>TABLE 8.2 Summary statistics for number of operators in the Urban Area (UA) and wider area, and, for (a) the operator that has the highest share of supply in the UA and (b) the operator(s) with the highest share of supply in the UA and wider area, their share of supply on all routes in the UA and wider area taken together</th>
<th>Mean</th>
<th>Median</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of operators in the UA &amp; wider area</td>
<td>9.72</td>
<td>9</td>
<td>1</td>
<td>42</td>
</tr>
<tr>
<td>Number of operators in the UA &amp; wider area with a share of supply of 10% or more</td>
<td>2.15</td>
<td>2</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Share of supply in the UA &amp; wider area of the largest operator in the UA (%)</td>
<td>52.0</td>
<td>53.5</td>
<td>3.9</td>
<td>98.3</td>
</tr>
<tr>
<td>Share of supply in the UA &amp; wider area of the largest operator in the UA &amp; wider area (%)</td>
<td>57.3</td>
<td>56.6</td>
<td>21.0</td>
<td>98.3</td>
</tr>
<tr>
<td>Share of supply in the UA &amp; wider area of the two largest operators in the UA &amp; wider area (%)</td>
<td>76.1</td>
<td>76.9</td>
<td>37.4</td>
<td>99.6</td>
</tr>
<tr>
<td>Share of supply in the UA &amp; wider area of the three largest operators in the UA &amp; wider area (%)</td>
<td>84.5</td>
<td>85.6</td>
<td>51.5</td>
<td>99.8</td>
</tr>
</tbody>
</table>

Source: CC analysis of Traveline data for October 2009.

8.125 Table 8.2 shows that the average share of supply run by the largest operator in an Urban Area is often lower if we also take into account the surrounding area. Still, in many instances the largest operator in an Urban Area also operates a very high share of weekly services on all routes within 12 km of that Urban Area as well. We find that in 15 per cent of Urban Areas in the database, the largest operator in that Urban Area operates three-quarters or more of total weekly services in the Urban Area and wider area, and in 41 per cent of Urban Areas the largest operator in that Urban Area operates 60 per cent or more of supply in the Urban Area and the area surrounding it.

Views of local bus operators on the constraint from potential competition

8.126 Arriva said that competition did not have to be, and often was not, through the provision of a fully competitive service offering by a competitor (ie it did not have to operate on the whole route or throughout the whole day). A competitor providing services only at times of peak demand could take disproportionately high levels of revenue. Arriva said that it therefore needed to take into account actual and potential competition from other bus operators and from other modes of transport in setting the different aspects of its offering such as the level of fares or frequencies. It said that this

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32 The extent of the constraint from potential competition is discussed in Section 8.
33 A buffer of 12 km was chosen to approximate the distance that a bus, at typical bus service road speeds, can travel within 30 minutes. In Section 7 of this report we conclude that, on balance, the evidence indicates that potential competition from operators with services and facilities within a radius of up to 30 minutes’ drive-time from a route is feasible, but the constraint from potential competition is likely to be weak at distances significantly greater than this.
also affected the time over which it planned aspects of its competitive offering, taking into account that Arriva was a long-term operator of local bus services.

8.127 FirstGroup told us that bus operators on all routes were constrained by potential competition, as they faced the risk of rival entry or expansion whenever their business did not deliver what customers wanted. FirstGroup told us that this was evidenced by its operating companies devoting significant time and resource to monitoring those aspects of their offerings that were valued by customers. FirstGroup told us that barriers to entry were low, and that entry or expansion could occur at the route level. It said that smaller operators were able to enter and expand in competition with larger operators, and hence exerted a constraint as potential competitors on Large Operators.

8.128 Go-Ahead told us that regardless of the actual market concerned, there was still significant threat from both actual and potential competition, because barriers to entry were low both for new or established operators. It said that incumbent operators (regardless of market share) must maintain a high standard of service to the benefit of the end-user or risk losing business to new entrants.

8.129 National Express told us that in the West Midlands the threat of expansion came from more than 50 local bus operators, many of which were small and dynamic and on the constant lookout to ‘cherry-pick’ the most profitable routes. National Express also told us that the threat of entry came from operators in adjacent areas. It said that the threat of entry might be at either the route or network level, with the threat of entry at the network level more likely to come from a larger operator. It also said that due to the threat of entry, it was continually looking to make improvements to its service, even on routes that did not face competition.

8.130 Stagecoach told us that there was considerable potential competition against its services and in the industry generally. It said that the extent of potential competition varied across different local areas. It told us that if an operator’s services were not meeting consumers’ needs, the possibility of entry became more acute and actual potential competition was more likely.

8.131 In some parts of the reference area, Mid-Sized Operators are the main incumbent. Lothian Buses told us that the existence of potential competition from other bus operators within a market (including threat of entry) was sufficient to protect the interests of consumers, in terms of pricing and quality. Where such potential competition and threat of entry existed, Lothian Buses told us that the consumer interest was not dependent on a market having a particular number of competitors operating within it. It said that potential competition was a particular constraint where there were significant levels of head-to-head competition in parts of a market, as this could reinforce the threat of further competition in the minds of those operators with significant market shares. It noted that where head-to-head competition existed in particular parts of an area, operators could easily expand their activities in competition with other incumbent operators.

Evidence from operators’ internal documents

8.132 If operators are constrained by potential competition, and are therefore taking deliberate actions in order to deter entry, we would expect some monitoring of potential

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34 FirstGroup initial submission and response to updated issues statement.
35 Go-Ahead initial submission.
36 Stagecoach initial submission.
37 Lothian Buses initial submission.
competitors’ activity. In addition, where operators take anticipatory steps to deter entry (such as a fare cut or service increase), perhaps in a response to a change in the threat from potential competition, we might expect to see evidence in documents setting out the rationale for those actions.

8.133 We set out the evidence from operators’ internal documents regarding how they take into account the threat of competition in paragraphs 6.62 to 6.72. The qualitative evidence we have seen suggests that potential competition from bus operators with facilities nearby exerts a constraint on local bus operators’ behaviour, although the strength of this threat appears to vary from one operator to another, and between the local operating companies of the Large Operators. The constraint posed by the threat of entry by Large and Mid-Sized Operators also appears stronger than the constraint posed by Small Operators. Recorded actions taken in response to potential competition focus on avoiding gaps in service provision and other aspects of service quality, rather than fares. The qualitative evidence therefore suggests that the constraint posed by potential competition is weaker in relation to fares than it is in relation to service quality, including frequency and network coverage.

Evidence from the performance-concentration analysis

8.134 Our performance-concentration analysis is described in detail in Appendix 7.1. Our analysis was carried out at two different levels of geographic aggregation: the Urban Area level and the route level.

8.135 Our Urban-Area-level analyses do not allow us to separate the competitive constraint offered by potential competition and the constraint imposed by head-to-head competition on a route. Instead our analyses at this level measure the effects on prices and frequency of a change in the number of competitors within an Urban Area.

8.136 Our route-level analyses are primarily designed with a view to assessing the effects of head-to-head competition on the route. However, we extended this analysis to look at the effects of potential competition. We adapted our base model from the route-level frequency analysis to include both a measure of head-to-head competition on the route and also a measure of the number of potential competitors (specifically the number of nearby rival depots). We found no positive evidence from our performance-concentration analysis to support the hypothesis that potential competition has a significant and systematic impact on route-level total frequency.38

Evidence regarding the extent to which incumbent operators are constrained by the threat of new entry

8.137 We now consider the available evidence regarding the constraint arising from the threat of new entry on the behaviour of incumbent local bus operators. We concentrate here on the anticipation of entry. The extent of actual entry and expansion and the impact of such events are discussed in paragraphs 8.153 to 8.160. We consider the views of operators on the constraint they face from entry, evidence from the operators’ internal documents and finally evidence from our analyses.

8.138 In general, we are considering new entry into commercial services. Tendered services are addressed in Section 13. However, we note that operators sometimes seek to establish themselves in an area using a base of tendered services before then seeking to expand into the provision of commercial services.

38 For further details of this extension to our route level analysis, see Appendix 7.1, Annex B, response 31.
8.139 New entrants differ from potential competitors in that they face a number of additional costs and potential barriers to entry. Most obviously, a new entrant needs to invest in a depot or similar facilities, and may also need to invest in other assets such as vehicles, driver training, branding and advertising and so on. Some of these costs will be sunk and it is possible that a new entrant will face higher or different categories of costs from a potential competitor who is expanding or reallocating resources. Other examples of possible barriers a new entrant might face include network and ticketing effects. These are outlined in Section 9.

Views of local bus operators on the constraint from entry and expansion

8.140 The Large Operators all told us that there were strong constraints arising from the threat of new entry similar to those arising from potential competition.

8.141 The Large Operators stated that barriers to entry were low in the local bus market. For example, Arriva told us that barriers to entry on any route were low, and that this implied, combined with the visibility of demand/supply, that an incumbent operator, if not exposed to head-to-head competition, was always exposed to the threat of competition on a route-by-route basis. Hence Arriva told us that it applied financial and operational key performance indicators equally across all of its operating companies and depots regardless of the level of competition, if any, it faced from other bus operators in the local area.39

8.142 National Express told us that the constant threat of entry or expansion by rivals kept existing operators ‘on their toes’, as a result of low barriers to entry. It said that it always sought to provide a high-quality and value-for-money service so that it did not leave a gap for a new entrant, so that even on routes where it did not face head-to-head competition, its behaviour was consistent with what would be expected in a competitive market.

8.143 FirstGroup told us that where it was not focused on delivering what the customer wanted, it risked a rival entrant coming into the local area. As a result, it told us that it ‘continually looks over its shoulder’ at potential new entrants to the routes it currently operated and would seek to avoid presenting opportunities to rivals to enter its existing routes in much the same way that it reacted to head-to-head competition.40 FirstGroup also told us that the lack of entry or expansion was because operators did not leave large opportunities for entry and expansion. It said that a ‘gap’ in the market that could be met by small-scale entry or expansion would attract such entry, and as such new entrants exploited such opportunities long before the time at which entry became possible.

8.144 Several operators (eg Arriva, Stagecoach and National Express) said that entry or the possibility of entry by a competing bus operator did not have to be on a significant scale in order to provide a significant constraint. They said that entrants, regardless of size, could target particular parts of the network, concentrating entry on the more profitable or popular routes in an area, or even just on part of a route and only at times of high demand. They therefore stated that this was sufficient for even a small operator to be regarded as an actual competitor.

8.145 We observe that within a local area, there tends to be substantial variation in the profitability of different routes; in many cases, a few routes may account for a large part of revenues and can often be the most profitable. Operators can therefore target

39 Arriva initial submission.
40 FirstGroup response to issues statement.
these most profitable routes. Several operators (such as National Express, Arriva and Stagecoach) referred to the practice of entrants ‘cherry-picking’ these routes, attracting revenue away from incumbent operators’ services by targeting the most profitable routes at the most profitable times. We were told that the profitability of particular routes could easily be judged based on how busy they were for the incumbent operator. We were therefore told that any targeted and successful entry/expansion focusing on an incumbent’s most profitable routes might pose a substantial constraint on a larger network incumbent, given the relative importance of these routes to the overall profitability of the network for the incumbent operator. FirstGroup also told us that multiple entry by different operators on a route level could have a significant impact on an operator’s passenger numbers.41

8.146 It was put to us that there had been many examples of successful entry and subsequent expansion. For example, Stagecoach, FirstGroup and Go-Ahead referred to examples of smaller operators which had grown significantly over the last five to ten years and which, they said, were now significant players in their local markets. Examples included: Konectbus (Norfolk),42 Norfolk Green,43 Western Greyhound (Devon Cornwall),44 Thuramston Bus (Leicester),45 Centrebus (Leicester),46 Choice Travel (West Midlands and Staffordshire),47 Rotala (West Midlands Worcestershire and Nottinghamshire),48 Baker Bus (Cheshire and Staffordshire),49 Welglade (eg Trent Barton in Nottinghamshire and Derbyshire),50 Veolia51 and Transdev.52,53

8.147 Nonetheless the Large Operators said that they generally ensured that they provided a service whereby entry opportunities were unlikely to arise, ie the threat of entry and expansion imposed an effective constraint. This indicates that low rates of market entry, rather than being indicative of barriers to entry or other constraints on competition, could reflect the constraints applying to incumbent operators. It was put to us that the amount of entry observed in the market was consistent with a static or declining market where operators were efficient and constrained by the threat of entry.54 FirstGroup said that the local bus industry had undergone considerable transformation in the years following deregulation. It said that the National Bus Company was inefficient, and in the years following its privatization there was significant entry to take advantage of this. It said that there was no reason to expect that barriers to entry had increased since deregulation, and no evidence that they had done so in practice. Therefore, it said that the fact that we had rarely seen entry in recent years was not because of constraints in the market, rather it was because small-scale entry was effective and because operators were now generally efficient and meeting the (declining) demand effectively.

Evidence from operators’ internal documents

8.148 In paragraphs 6.62 to 6.72, we looked at how operators perceived and responded to potential competition. There was little or no reference in the internal papers to con-
sideration of the threat of new entry, over and above any considerations of a possible constraint imposed by potential competition from operators already in the area. Instead where entry occurred, operators then considered how to respond.

8.149 There is some evidence that when an operator suspects that a nearby rival small operator will be acquired by a large or mid-sized rival, it perceives a greater threat (see paragraphs 6.65 and 6.68). This indicates that the constraint offered by a larger-scale operator is considered to be greater when it is nearby, thus indicating that potential competition is a stronger constraint than the threat of new entry. It also shows that larger-scale operators may exert a stronger competitive constraint from potential competition than smaller operators.

Evidence from our analyses

8.150 It is difficult to isolate the threat of entry and expansion as constraining factors in our analyses in that, were they to form an effective constraint (ie with no barriers to entry applying), it would apply to all local areas and so its effectiveness could not be deduced directly from differences in outcomes in different areas. We note, however, that there are differences in outcomes observed in different local markets, as illustrated by, for example, our performance-concentration analysis (see paragraphs 7.35 to 7.37). This indicates that the presence or absence of head-to-head competition has a significant effect on market outcomes and therefore the threat of potential competition and new entry is not sufficient to constrain incumbent operators.

8.151 Our profitability analysis (see paragraphs 10.85 to 10.89) found that operators representing a substantial part of the market have earned profits that were persistently above the cost of capital on a national basis. We therefore conclude that competition may not have been wholly effective across the reference area.

8.152 In paragraphs 6.105 to 6.143, we discuss examples of how incumbent operators have responded to entry. This indicates that in many cases entry and expansion induce further reaction over and above any impact from the anticipation of these occurring.

Experience of entry and expansion

8.153 The discussion above refers to the constraint on operators imposed by the anticipation of entry and expansion, ie the extent to which the possibility of entry and potential competition act as a constraint. Actual experience of entry and expansion is informative although interpretation of the significance of the observations is difficult. Substantial entry and expansion can show that incumbent operators may be punished if they fail to take account of these constraints, and it can show that any barriers to entry and expansion are small or can be overcome. However, low rates of entry could mean either that incumbent operators are fully taking account of and responding to constraints, or that there are significant barriers to entry and expansion.

8.154 In paragraphs 6.74 and 6.75, we considered the incidence of entry and expansion in local bus services using two different methodologies. While a considerable number of entry events have been identified, the results suggest that small-scale entry and expansion is more common than large-scale entry and expansion, and that the great majority of Urban Areas did not experience any large-scale entry in the last five years.
In paragraphs 6.76 to 6.104, we describe the methods of entry and expansion that have been adopted by bus operators. There were a wide variety of reasons given for the entry and expansion that we have observed including:

- replacement of withdrawn services (eg see paragraph 6.104(a));
- to build on resources used for tendered services to provide commercial services at other times of the day (eg see paragraph 6.104(b));
- small-scale opportunistic entry, entry in response to perceived gaps in service (eg see paragraph 6.104(d)), to differentiate their services, or in response to a decline in service quality by incumbent operators (eg see paragraph 6.104(e));
- entry to exploit the perceived financial weakness of an incumbent in order to force or take advantage of a sale (see paragraphs 6.84 to 6.88); and
- large-scale entry and expansion where a strategic opportunity is identified (eg see paragraphs 6.97 and 6.101).

This suggests that, at least to some extent, operators are taking advantage of opportunities to enter and expand in response to perceived weaknesses in their rivals’ offers. However, this only tells us that entry occurs. It does not tell us whether all or most possible opportunities lead to entry, nor does it demonstrate whether entry and expansion are necessarily successful or whether responses to competition can lead to the entrant being forced to exit within a short period.

We have received evidence that entry and expansion have had significant impacts in particular local cases, eg the growth of Norfolk Green and Western Greyhound from their initial entry based on tendered services. Stagecoach’s new entry into north Devon (again initially based on tendered contracts) and Sheffield (following acquisition) have had a significant impact on outcomes in these local markets.

The significance of any entry and expansion in a local area, in terms of its impact on incumbents and competition, will depend on the size of the local market being considered and its existing competitive landscape (eg the number of incumbent operators). Therefore, the scale of entry or expansion in absolute terms—eg fleet size, number of routes, etc—needs to be viewed relative to the size of the local market.

FirstGroup and Stagecoach provided evidence on the number of buses required to serve different-sized towns or cities. FirstGroup told us that 100 buses would be large enough to serve a population of around 140,000 (for example, York or Doncaster). Stagecoach told us about the number of vehicles required to serve its networks in several towns or cities: Carlisle (population over 100,000) served by [X] buses; Eastbourne (population 97,000) served by [X] vehicles; Hartlepool (population of 90,000) served by [X] buses; Peterborough (population of 164,000) served by [X] vehicles; Oxford served by [X] vehicles, with a further [X] vehicles on services into Oxford and out of town (including Oxford Tube express coach service); and Sheffield served by [X] vehicles. Arriva also told us that towns with a population of less than 100,000 would most commonly be served by a fleet of 50 buses or fewer.

Some examples of entry and expansion events which had a significant impact on the local market concerned are given below:

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55 These figures relate solely to local town services and do not take into account buses operating outside the town but carrying local passengers within the town network.
(a) Arriva’s expansion into Chester (at the time when the council put its business up for sale) was ten PVRs. This duplicated Chester City’s network and had a very significant impact (see paragraphs 6.58(c), 6.84, 6.92 and 6.137).

(b) In Preston, Stagecoach’s entry (see paragraph 6.85).

(c) FirstGroup’s expansion in Plymouth in October 2009 involved 24 buses (see paragraph 6.87).

(d) Stagecoach’s entry in north Devon (see Appendix 6.4—North Devon).

(e) In Weston-super-Mare (see paragraph 6.136), ACL’s entry with fewer than ten buses on three routes appears to have had a significant impact on FirstGroup.

(f) Rotala’s entry in Worcester was with 32 buses (much of which was on tendered services) (see Appendix 6.4—Worcester, paragraph 70).

(g) In Cumbernauld (see paragraph 6.138(b)), FirstGroup estimated that Stagecoach’s entry against it was with a PVR of approximately 20 buses.

(h) Go-Ahead observed in the Birmingham case study (see Appendix 6.4—Birmingham, paragraph 21) that.

Conclusion on the constraints from potential competition and new entry

8.161 We find that in principle incumbent bus operators that do not face head-to-head competition from other bus operators may be constrained by potential competition. This may limit their ability to exploit fully a monopoly on a particular route or flow.

8.162 The strength of the competitive constraint on incumbents is dependent on the nature of the potential entrants that the incumbent faces. Incumbent operators will be more likely to restrain their prices and where this is the case will restrain their prices to a greater degree, in anticipation of entry, where there is a potential entrant with relatively lower entry costs. The evidence in Sections 7 and 9 shows that entry costs are lower where an entrant has nearby services and facilities, where the entrant is a larger operator relative to the size of the incumbent, where the entrant has a network of services that deliver a comparable network advantage in the local area, and where area-specific barriers to entry are absent. The strength of the constraint on incumbent operators is also likely to be influenced by the nature of post-entry competition.

8.163 Because these factors vary depending on the configuration of operators’ respective services and facilities in an area, the degree to which potential competition will constrain incumbent operators that do not face head-to-head competition will also vary. This was reflected in the evidence that we saw regarding the constraint from potential competition. We found that in some circumstances incumbent operators take actions in advance of entry. However, there were also instances where this did not appear to be the case. We found that the constraint posed by the threat of entry by Large and Mid-Sized Operators may be stronger than the constraint posed by the threat of entry by Small Operators. We were unable to distinguish head-to-head and potential competition in our Urban-Area-level performance concentration analysis. Our route-level analysis was designed to capture the effects of head-to-head competition; however, we extended our analysis and found no positive evidence that potential competition was a systematic constraint on incumbent operators.

8.164 We conclude that potential competition can act as a constraint on incumbent operators’ behaviour but this constraint is not pervasive across all areas and is dependent
on specific local circumstances set out in paragraph 8.114. We find that while the threat of entry may exert a constraint on operators and may influence their conduct, the evidence does not suggest that this is a strong constraint. We also find that the strength of the constraint from new entry is likely to be less than the strength of the constraint arising from potential competition.

8.165 As discussed in paragraphs 8.108 to 8.110, the strength of the constraints from potential competition and new entry depend on the presence and nature of any barriers to entry, and the nature of post-entry competition. Barriers to entry are considered in Section 9.

**Operator conduct and geographic market segregation**

*Introduction*

8.166 The discussions above describe the nature of competition between operators and the conditions under which competition between operators takes place. Our concern in this section is whether operators are able to restrict or avoid competition to their mutual benefit and whether this leads to geographic market segregation.

8.167 Such an outcome could occur if operators chose not to compete as actively as they otherwise would, due to a recognition that there would be a mutual advantage in limiting the extent of competition between them. This mutual advantage might arise if operators consider competition to be costly, and have an expectation that by refraining to compete with their rivals, their rivals may similarly refrain from competing with them.

8.168 Under geographic market segregation, operators avoid expanding to compete head-to-head with their rivals in the same areas or on the same routes to their mutual benefit. An outcome of this type could be achieved tacitly—ie without parties explicitly agreeing to avoid competition with one another—or could be reached through more explicit means.

8.169 We have received a large volume of documentary evidence relating to activities that may create or reinforce geographic market segregation. Much of this evidence relates to the conduct of Arriva and Go-Ahead in the North-East of England, and our consideration of this evidence has led us to conclude that operator conduct has resulted in geographic market segregation in this area. However, we have also seen further, but more limited, evidence of behaviour appearing to promote geographic market segregation taking place in some other parts of the reference area.

8.170 The direct observation of geographic market segregation may be difficult. If it is successful we might see no more than stable market structures in which operators tend to avoid direct competition, but such an outcome may be consistent with a number of different explanations and so may not in itself provide evidence of geographic market segregation. No actions to create or reinforce geographic market segregation may be necessary. Where it occurs, it may be masked by genuine competition in neighbouring areas or by retaliation that may be difficult to distinguish from competition on the merits. Coordination is unlikely to be acknowledged or recorded by operators. The consequence of this is that it is very difficult to draw conclusions on whether operator conduct has led to geographic market segregation, other than in those instances where documentary evidence is available illustrating such conduct to have taken place.
8.171 We emphasize that we have not conducted an investigation into whether there has been a breach of the Chapter I prohibition in the 1998 Act or a cartel offence. While coordination may in principle occur across a range of competitive variables, we have not received evidence of operators coordinating in other dimensions such as fares or aspects of service quality.

8.172 Our assessment of geographic market segregation is structured in three parts:

- First, we briefly set out the general views of operators and LTAs on geographic market segregation in the reference area (paragraphs 8.173 and 8.174).

- Second, we consider a variety of documentary evidence relating to geographic market segregation in certain parts of the reference area. In particular, we evaluate evidence drawn from the internal documents of three of the Large Operators relating to conduct mainly in certain parts of the North-East and North-West of England. On the basis of these documents we make some observations concerning the role of territories, retaliation and signalling, communication between operators and asset sales in promoting geographic market segregation in these areas (paragraphs 8.175 to 8.212). We also discuss the comments of some of the Large Operators on our assessment (paragraphs 8.213 to 8.234).

- Third we discuss the extent to which geographic market segregation is likely to arise in the reference area more widely. We assess whether the general conditions for tacit coordination are likely to hold in the local bus industry, and so whether geographic market segregation may take place even in the absence of explicit measures on the part of operators to bring it about (paragraphs 8.239 to 8.243). We then consider whether market structure and the extent of competition in the reference area is such that a wider pattern of geographic market segregation could, in principle, be of concern (see paragraphs 8.244 to 8.254). Finally we discuss whether geographic market segregation might apply to different types of operators (see paragraphs 8.255 to 8.257).

Parties’ views on geographic market segregation

8.173 The submissions of a number of parties indicated a perception of geographic market segregation in the reference area. In particular, a number of the PTEs/LTAs/RTPs discussed geographic market sharing within their areas, noting that the largest operators in their areas tended to enjoy ‘local monopolies’, despite these operators’ depots being located close to each other. In addition, some local bus operators told us that the Large Operators were reluctant to enter into direct competition with each other. These submissions are set out in Appendix 8.3, paragraphs 2 to 6, and 14 and 15.

8.174 However, a number of operators told us that they did not recognize any geographic market sharing, and did not engage in behaviour such as reactions or retaliation to entry which would have the effect of geographic market sharing. They told us that entry and expansion decisions were taken on the basis of commercial opportunities, rather than as part of any retaliatory strategy. Various alternative explanations of the structure of the industry were proposed. Their submissions are set out in Appendix 8.3, paragraphs 7 to 13.

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56 Notwithstanding this, the CC has the power under section 241 of the 2002 Act to disclose to the OFT information received in the course of its inquiry, and we have discussed the evidence that we have received with the OFT.

57 See paragraph 8.176.
Evidence of geographic market segregation

8.175 Notwithstanding the difficulty of collecting evidence relating to geographic market segregation, we received and considered a range of information from three large operators (Arriva, Go-Ahead and FirstGroup) relating to certain parts of the reference area that is relevant to our assessment. This evidence—largely taking the form of contemporaneous internal papers—provides indications of these operators’ perceptions of local markets, their perceptions of rivals and how they compete, and how they determine their competitive strategies.

8.176 In particular, the disclosure by Go-Ahead of a series of internal notes (received in late July 2011), produced between January 2006 and August 2009, and relating to competition between Go North East (GNE) and Arriva North East (ANE), prompted us to seek further information from and hold hearings with Go-Ahead and Arriva. Similarly we also considered afresh competition between Arriva and FirstGroup in Chester and the Wirral (which we refer to as the North-West, although our investigation related specifically to these two areas), and examined evidence relating to discussions between FirstGroup and Arriva concerning operations in other parts of the reference area, particularly Leicester and [X].

8.177 In Appendix 8.5, paragraphs 4 to 8, we draw attention to some of the difficulties encountered in our investigation of geographic market segregation in the North-East. Some difficulties in verifying events are also referred to in Appendix 8.6, paragraphs 24 to 51. We have encountered a variety of difficulties in collecting written and oral evidence that are not all explained by the distance in time from some of the events reviewed. As we say in Appendix 8.5, we do not wish to make too much of any individual inaccuracy. However, such inaccuracies can limit the weight that we can attach to the representations made to us.

8.178 The evidence that we gathered as a result of the further enquiries described in paragraph 8.176 is set out in two appendices:

(a) Appendix 8.5: Evidence from the North-East; and

(b) Appendix 8.6: Evidence from the North-West and other areas.

8.179 In Appendix 8.5, we describe a series of events between 2005 and 2010 involving GNE and ANE. The evidence relates to a number of specific routes and areas of the North-East, but does not cover the whole of the region and does not relate to other operators. The picture that emerges is complex. However, there is evidence that these operators regarded particular areas as their own territory and chose to respond aggressively to entry by other operators who encroached on their routes in these areas. We also see evidence of these two operators considering different means in order to reduce the extent and intensity of competition between them including: withdrawal from competed routes in the expectation that a similar reaction might arise from the rival; discussion of the introduction of a partnership scheme, which, if implemented as proposed, would have likely had the effect of limiting competition; mutual route sales to limit competition; and the mutual sale and purchase of depots in order to achieve operating efficiencies but where the effect would also be to reduce the extent of competition between operations. We note that there were extensive contacts between these operators, which included discussions to these effects as well as

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58 Our observations relate to a limited number of routes in and around Chester and the Wirral, and do not refer to the region as a whole.
59 We note that Nexus had previously told us that in its view there were generally operator ‘territories’ and little head-to-head competition between operators in Tyne and Wear—see Appendix 8.3, paragraph 2.

8-33
threats of retaliation. In 2010, there were two linked asset sales between GNE and ANE. Depots at Ashington and Hexham and associated assets were sold such that ANE bought GNE’s Ashington depot (and integrated its services into its existing operations) while ANE withdrew from its Hexham base which was acquired by GNE. The OFT investigated these mergers and found a realistic prospect of an SLC in each case on certain routes. However, they were not considered by the CC as the OFT exercised its discretion not to refer on the grounds of de minimis.

8.180 As set out in Appendix 8.6, in Chester and the Wirral (the North-West), the documentary evidence shows that Arriva and FirstGroup engaged in retaliatory action in response to competitive initiative from each other. We also saw some contacts between senior managers referring to these actions. One activity considered, although not pursued, was the mutual sale of buses between these operators where the vehicles concerned were deployed on competed routes. Our review of internal documents surrounding the transaction, combined with the fact that each operator was proposing to buy and sell a similar number of vehicles, have led us to conclude that the likely intention was for this to serve as a signal to refrain from head-to-head competition on these routes. Similarly, there was consideration of mutual depot sales by these operators covering a variety of areas; in many of these they were in competition with each other. Again these ideas were not pursued; however, we note further evidence of retaliatory responses between these operators in Leicester.

8.181 In addition to the evidence set out in these appendices, we also identified information of relevance to our assessment of geographic market segregation as part of our more general review of operators’ internal documents (the output of which we discuss in full in Section 6). This information is referred to where appropriate in our discussion below.

8.182 The evidence that we have received relates to four aspects of operator conduct:

   (a) the notion of Core Territories (see paragraphs 8.184 to 8.190);
   (b) retaliation and signalling (see paragraphs 8.191 to 8.198);
   (c) communication between operators (see paragraphs 8.199 to 8.206); and
   (d) sales of depots and assets (see paragraphs 8.207 to 8.212).

8.183 Our analysis of operator conduct in the North-East has shown that all four of these aspects have been present in that area, and have led to geographic market segregation.60

   The notion of Core Territories

8.184 In the North-East and North-West we have seen evidence that the notion of operators having territories is understood and recognized by operators in these areas. This notion promotes some common understanding of those parts of an operator’s network on which it will not expect rivals to compete that is necessary for geographic market segregation to take place. We refer to such areas as operators’ Core Territories. Although there need not be a common understanding of the full extent of each operator’s Core Territory for geographic market segregation to occur, a more

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60 However, we note that it is not the case that all of these aspects of operator conduct are necessarily required for geographic market segregation to take place, and such an outcome might in principle arise in the absence of any such actions on the part of the operators (as discussed in paragraph 8.243).
extensive common understanding is likely to promote a more stable coordinated outcome.

8.185 More specifically, in the North-East, we have found reference in the internal documents of GNE to different operators’ ‘territory’, ‘patch’ or ‘core network’, and the evidence of [Opco Manager 3, ANE] also illustrates a recognition within ANE that different operators were concentrated in different areas (see Appendix 8.5, paragraphs 66 to 74 and 120 to 124). Internal documents relating to the North-West show that operators’ territories were also recognized by FirstGroup in that area (see Appendix 8.6, paragraph 61(a)).

8.186 We consider that the idea of a Core Territory denotes something more than merely where a service is operated. For example, documents produced by GNE provide clear evidence of its expectation that in its Core Territory it would run services without challenge by ANE. More generally, we have found evidence that if a rival were to encroach on the Core Territory of Arriva, FirstGroup or Go-Ahead in the North-East, the North-West or Leicester, it could expect retaliation. Retaliation to competitive incursions in Core Territories appears to be different in nature from reactions to a rival’s changes in services or service frequency in ‘non-core’ or previously contested areas. Our evidence relating to retaliatory responses by these Large Operators is discussed in paragraphs 8.191 to 8.198.

8.187 The evidence of geographic market segregation in the North-East and North-West of England has led us to conclude that the boundaries of Core Territories in these areas are not precisely defined. There are many overlaps between bus operators’ routes, and operators may not therefore always hold precisely the same understanding of where the boundaries of each other’s territories lie. Because operators enter on routes and compete on overlaps, a Core Territory could refer to particular routes or sections of those routes, rather than a broader geographic area. Consequently competition might be tolerated on some routes but entry on others may invoke a retaliatory response.

8.188 However, we would expect the broad location of rival operators’ Core Territories in these areas to be commonly understood. In particular, operational considerations will mean that operators are confined to serving distinct areas around their depots, and this will cause their networks to be centred on particular areas. Looking at the reference area as whole, the stability of the local bus market (see paragraph 8.246 below) means that in many cases historic operating areas have not changed, and the areas covered by operators’ networks are relatively invariant over time (we note references in GNE documents to ‘traditional’ corridors, and a route that had been served ‘for over half a century’—see Appendix 8.5, paragraphs 66 to 68). Taken together, these factors suggest that operators will have a broad mutual understanding of each other’s Core Territories where they have operations that are located close to one another, such as with Arriva and Go-Ahead in the North-East, and Arriva and FirstGroup in the North-West.

8.189 In addition to this, the evidence from the North-East and North-West highlights various actions operators can take which may serve to reinforce a common understanding of Core Territories, including retaliation and signalling (see paragraphs 8.191 to 8.198), communication (see paragraphs 8.199 to 8.206) or the discussion (or completion) of mutual asset sales (see paragraphs 8.207 to 8.212).

8.190 Therefore, despite the potential for operators to have different perceptions of the exact scope of each other’s territory, we consider that these operators would in general have a common awareness of each other’s Core Territories.

8-35
Retaliation and signalling

8.191 The evidence relating to the North-East, North-West and Leicester set out in Appendices 8.5 and 8.6 shows that three of the Large Operators (Arriva, Go-Ahead and FirstGroup) are, in at least some cases, prepared to respond aggressively should entry into their Core Territories occur. Outside these areas, operators often overlap and compete without such responses being triggered.

8.192 For geographic market segregation to occur, operators must be aware that entering a rival’s Core Territory may provoke a reaction that will be detrimental to their overall profits (even if such an incursion would be beneficial in the shorter term). In principle, this reaction may simply be a reversion to competition on the merits, or may involve a particularly aggressive response that goes beyond a normal competitive response in that it has the primary objective of imposing a cost on the entrant by extracting revenue from their core operations. We label the latter type of reaction—which might take place on the same route or in a different area—‘retaliation’.

8.193 We have received evidence of a number of different types of retaliatory responses being taken. In the North-East, we have seen retaliatory entry on to other routes in the area, increases in services on other shared routes, or expansion of operations. In the North-West and Leicester, we have seen examples of retaliatory entry on to other routes in the same area and further afield.

8.194 Specifically, examples of retaliation documented in Appendices 8.5 and 8.6 include:

- A series of retaliatory registrations between Arriva and GNE in the North-East as detailed in Appendix 8.5, paragraphs 25 and 26. Consideration of the retaliation element of these actions is set out in Appendix 8.5, paragraphs 75 to 101.

- Retaliation by FirstGroup by registering services on the Wirral against Arriva in response to competition from Arriva in Chester (see Appendix 8.6, paragraph 12), and by Arriva against FirstGroup (see Appendix 8.6, paragraph 16).

- Responses by FirstGroup in registering new services against Arriva in Leicester, to which Arriva similarly responded (see Appendix 8.6, paragraphs 63 to 66).

8.195 These examples show an intent to punish rivals for entry, which we interpret as retaliation of the type discussed in paragraph 8.192. We have seen no evidence that these actions were taken for other reasons, such as to exploit profitable opportunities. Instead, these actions are described in internal documentation as direct responses to the competitive incursions of rivals, and followed rivals’ actions within a short period of time. In general, the retaliatory actions that we have observed have been confined to broadly the same part of the reference area as where the competitive incursion took place, or a neighbouring area.61

8.196 Our more general review of operators’ internal documents—which is set out in Section 6—shows that some of these operators have also considered retaliating to competitive incursions by a rival elsewhere in the reference area. In particular, as we discuss in paragraph 6.138, FirstGroup’s internal documents show that where Stagecoach has entered on its routes in Glasgow, Yorkshire and Devon, FirstGroup

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61 We have seen one example where an operator indicates in its internal papers when contemplating entry into a new area through acquisition that one consideration is that it would serve as retaliation for a rival which had previously entered a different region in competition with it, and identifying this as its rival’s core area. However, the acquisition appears to have been motivated by the identification of possible market opportunities. We therefore do not treat this as an example of cross-territory retaliation. It does, however, illustrate the understanding of the concepts of territory and retaliation within the industry.
has considered retaliating against Stagecoach (although, aside from the reference to the Ayrshire example in the 1990s, it has not followed through with these actions). Similarly, internal documents suggest that Go-Ahead responded to competition from FirstGroup in Plymouth by launching a new route in another area of the city (see paragraph 6.139).62

8.197 We have also found that in order to limit competitive exposure or bring an end to costly periods of retaliation, operators may seek to signal their intentions to each other, as an alternative to more explicit discussions. We have observed such ‘signalling’ taking two forms.63 First, registration of new services may signal that the operator intends to retaliate (eg Appendix 8.5, paragraph 82). This retaliation occurs when geographic market segregation partially breaks down. Second, deregistration similarly may provide a signal that the operator may be seeking to put an end to retaliatory actions and to return to some kind of pre-existing equilibrium (eg see Appendix 8.5, paragraphs 85 to 87). We have not found evidence that operators signal using fares or other aspects of the quality of their service. Rather, signalling seems to focus on the services an operator runs and where they operate.

8.198 In some instances, it appears that the signalling that we have observed has not been interpreted as intended and has not led to an immediate response. For example, Arriva did not withdraw from services in the Blacon corridor in response to FirstGroup’s deregistrations in the Wirral (see Appendix 8.6, paragraph 23), and did not withdraw new services in Leicester following FirstGroup’s deregistration of Oadby services (see Appendix 8.6, paragraph 67). Nevertheless, the fact that these actions were taken shows that these operators had some expectation that they would be successful in dissuading rivals from entering their Core Territory.

Communications between operators

8.199 Communication between operators may play a role in reinforcing geographic market segregation by advancing a common understanding of the terms of coordination. Such communication can take a variety of forms and serve a number of purposes.

8.200 We have found in the North-East and North-West a high level of contact between two of the Large Operators at various levels of seniority. Discussions between Arriva and FirstGroup in the North-West took place in a different context to discussions between Arriva and Go-Ahead in the North-East, and the frequency of contacts was less in the case of the North-West. However, in both areas we have been struck by the sensitivity and specificity of the topics discussed, including in some instances a willingness to disclose what would ordinarily be regarded as commercially sensitive information, not least because Large Operators have competition compliance programmes in place. In our view, the extent of contacts goes beyond what would normally be expected between competitors.

8.201 Specifically, as noted in Appendix 8.5, paragraphs 149 to 152, in the North-East there were frequent contacts between GNE and Arriva, including the disclosure of financial information in relation to possible route and asset sales, commercial strategies, and suggestions for options to reduce competition, across routes and operating areas. The extent of discussions between Arriva and FirstGroup about Chester

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62 The evidence that we have seen highlights the existence of a more widespread barrier to entry and expansion in the form of retaliation. In particular, because we have found evidence of retaliatory conduct in several areas, it is likely that operators in general may perceive, in advance of entry, a risk that incumbent operators will retaliate on other routes, whether or not this then occurs. This is discussed in paragraphs 9.58 to 9.65.

63 In the following we use the term ‘signalling’ broadly to include indirect communication of intended actions, rather than confining it to the narrower interpretation often used in the economics literature.
and the Wirral are less certain, although contemporaneous written records indicate that conversations about their respective commercial operations took place.

8.202 These communications took place at different levels of seniority. In particular, in the North-East most communications occurred at the operating company level. However, senior managers were involved in discussions regarding potential asset sales. In the North-West, communications took place between senior managers in Arriva and FirstGroup.

8.203 In the case of the North-East (see Appendix 8.5, paragraphs 125 to 130), there was also discussion of a partnership scheme. Arriva told us that ‘the effect of the Quality Bus Network Partnership as proposed by [OpCo Manager 1, GNE], if endorsed by the appropriate Local Authorities, would have been to abate competition between the rival companies in the area covered’. While this was not pursued, it raises a concern that operators could more generally perceive partnerships as an opportunity to diminish competition between them.

8.204 We are concerned that, where it occurs, such communication is likely to have had the effect of sharing information which will help operators to develop an understanding of each other’s operations, tactics and interests. This may be the case even if the communication is not explicitly intended to facilitate geographic market segregation. We consider that such discussions will help operators to develop a mutual understanding of where the boundaries of acceptable competition lie, whether actions are intended to breach these boundaries or not, and to signal whether retaliatory action might be taken.

8.205 We understand that communication between competitors is sometimes necessary and appropriate. There is a considerable political and social dimension to local bus services. There are also instances where operators are required to cooperate, such as on delivering integrated public transport, and multi-operator ticketing schemes. Operators may also have legitimate interests in the sale and purchase of assets. However, as stated above, the extent of contacts we have seen is more widespread than we would expect and sometimes covers commercially sensitive information.

8.206 Because of this, we are concerned that this communication could serve as a basis for developing a mutual understanding of tactics and objectives that would assist in allowing operators to avoid or mitigate head-to-head competition and reduce the threat of potential competition.

Sales of depots and assets

8.207 The evidence in the appendices documents a number of instances where three of the Large Operators have communicated bilaterally over the possible sale of assets and depots in the reference area (although only one of these deals has come to fruition). This evidence is set out in Appendix 8.5, paragraphs 29 to 38, and Appendix 8.6, paragraphs 41 to 55 and 71 to 77. Asset sales may be normal business practice, increasing operating efficiencies or allowing more efficient operators to develop a business. The anticompetitive consequences of transactions are subject to legislation on illegal market sharing and the merger regime. However, we considered whether the consequence of the proposed sales may have been to reinforce geographic market segregation and facilitate a broader understanding among the operators involved about the limits of competition between them (as shown, for example, by the reference to ‘achieving a robust long-term deal’ in Appendix 8.6, paragraph 136).

8.208 We observe a number of unusual aspects to the negotiations in the transactions or proposed transactions that we have reviewed, which indicate that the objective may
be driven, at least in part, by a desire to limit competition and reinforce geographic market segregation:

(a) We note that in each case the negotiations have generally been between operators already present in an area. We infer from this that competition between the operators is a significant consideration within the negotiations, given that we have found little evidence of regional economies of scale.

(b) In the case of the North-East Transactions (see Appendix 8.5, paragraph 34), we note that a theme of negotiations was that the sale of assets to each party should be of similar value. We would expect that if there were reasons to sell assets because they were underperforming or fitted poorly with a portfolio of operations, an operator would identify these and then seek offers from a variety of operators to maximize the disposal value. A target of mutual balancing of operations is not explained by the desire to dispose of underperforming assets or acquire new assets.

(c) We also note that the focus of some of the proposed transactions was limited to the exchange of routes and vehicles. For example, initial discussions and proposals in the North-East Transactions centred on services on particular routes, rather than consideration of any efficiency or other benefits from depot sales. It appears that the reason why a route and vehicle sale was not pursued in the North-East was because it was considered likely to be difficult to obtain merger clearance for that sort of transaction. Similarly, in the North-West the proposed transaction was based around an exchange of vehicles. While such exchanges may allow some services to be operated more efficiently or depots to be used more effectively, because the proposals primarily related to contested routes, this indicates that a reduction in competition is a significant factor in the transactions. We note in the North-West references in internal documents to avoiding future competition on routes included in the deal being in the implied ‘spirit’ of the transaction.

8.209 In the case of the one completed depot deal—the Transactions in the North-East—we conclude that a consequence of the transactions was to extend the degree of geographic market segregation between these operators by reaffirming each operator’s territory and removing overlap between them. We note that the OFT found that both of these transactions created a realistic prospect of an SLC arising through a reduction in actual competition, and in one case, a reduction in potential competition, although the OFT exercised its discretion not to refer the acquisitions to the CC for in-depth investigation on grounds that they were de minimis. A two-year non-compete clause built into the contract of the transaction has ensured that the parties have not re-entered on the routes from which they withdrew.

8.210 We have also seen proposals for mutual exchanges of businesses where the effect would have been to remove completely an operator from an area—for example, see Appendix 8.6, paragraphs 71 to 77. Although these transactions never took place, we consider that if they had, the effect of such a sale would be to reinforce geographic market segregation by removing head-to-head competition between operators.

8.211 In addition, where mutual exchanges of assets have been proposed but not realized (for example, see Appendix 8.6, paragraphs 41 to 51), our interpretation is that the proposed sale of vehicles may have acted as a signal for rivals to withdraw from operations on specific routes in return for a reciprocal recognition on other routes. The discussion may also have served to bring clarity to operators’ understanding of each other’s Core Territories.
8.212 It has been put to us that it is entirely normal for operators to consider whether poorly-performing operations could profitably be sold to a rival which might be better able to improve their results, and that the merger regime existed to monitor and control any anticompetitive consequences of such processes. The challenges involved in obtaining evidence which can be used to assess coordination between operators are set out in paragraph 8.170. Given these challenges, our view is that our in-depth investigation of the circumstances surrounding the Transactions has shed considerable further light on their implications for geographic market segregation and competition.

**Operator comments on the CC’s findings**

8.213 A number of the Large Operators commented on our provisional findings on geographic market segregation and on the evidence on which they are based.

8.214 Arriva told us that ‘there is no evidence that Arriva considers any part of the country, or any group of routes, the preserve or territory of another operator with the concomitant view that no incursion into that territory should be made’. It said that because the bus industry was a network business, practical considerations would naturally cause operators to have territories. It told us that the CC had provided no evidence that firms had any common understanding of the boundaries of each other’s core territories, and that this made coordination difficult if not impossible. It said that Arriva did not accept that there was a concept within the industry of exclusive territories.

8.215 Go-Ahead told us that references to patches were used colloquially to describe the markets in which it operated. If an operator were to commence a service that did not appear to be commercially or economically justified, this may have been viewed internally as an aggressive move and as a result might have been described informally as an encroachment on its territory. The references should not be taken to be reflective of a general understanding between Go-Ahead and Arriva as to territories.

8.216 As set out in paragraph 8.188, practical considerations will mean that operators are generally confined to serving distinct areas around their depots, and this will cause their networks to be confined to particular areas. We consider that this aspect of the bus industry will allow operators to form a broadly common understanding of each other’s Core Territories. We have seen clear evidence of retaliatory strategies and other actions that lead us to conclude that in the North-East, operators’ understanding of each other’s Core Territories has gone beyond a simple recognition of the location of their network, and that in this area operators viewed their Core Territory as their own preserve and were willing to take actions in order to reinforce this.

8.217 Arriva said that there was no evidence that the objective of retaliatory actions highlighted by the CC was to force entrants to withdraw.

8.218 We have seen clear evidence linking aggressive retaliatory actions by operators to competitive incursions by their rivals. The timing of these actions and discussion surrounding them suggests that they were implemented with the intention of imposing a cost on the operator. Irrespective of whether or not these actions have had the

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64 Arriva response to the addendum to the provisional findings on geographic market segregation and operator conduct, paragraphs 2.1, 2.2 & 3.4.
65 Arriva response to the addendum to the provisional findings on geographic market segregation and operator conduct, p9.
66 Go-Ahead response to the addendum to the provisional findings on geographic market segregation and operator conduct, paragraphs 2.12–2.13.
67 Arriva response to the addendum to the provisional findings on geographic market segregation and operator conduct, p7.
effect of forcing the target operator to withdraw, they will add to the disincentive to encroach on their territory in the future.

8.219 Arriva told us that retaliation was part of the normal competitive process. In particular, it said that ‘Faced with competition no business in any industry is going to concede a profitable share of supply, without a fight … Seeking passengers on another route … is not an attempt at coordination but rather an attempt to attract additional, hopefully profitable, revenue.’ Similarly, Stagecoach told us that ‘there is no basis for concluding that entry actions are retaliatory. There is a constant competitive dynamic in areas, which should not be mistaken for retaliation.’

8.220 There is a clear distinction between a normal competitive response to entry (ie competition on the merits) and the behaviour that we have observed that we term retaliation. In particular, retaliation is an aggressive response to competition that has the primary objective of maintaining geographic segregation by imposing costs on the rival so as to dissuade future entry and extract revenue from the entrant’s operations such that they may be forced to withdraw. This may not in itself be profitable. In contrast, a normal competitive response to entry will have the objective of profitably competing to win passengers on the route that is subject to entry, via an improvement in offering.

8.221 It will generally not be possible to determine whether a response to entry is retaliatory or not by simply observing it when the response occurs on the same route as the entry itself, as the two reactions are likely to manifest themselves in a very similar way (eg robust competition for passengers in the form of increased frequency). However, where a competitive incursion causes the incumbent to retaliate by changing a registration or making a new registration in a different area where the entrant is active, this cannot be explained as a normal competitive response. While in any given area there may be an ongoing process of competition which will involve operators changing the extent to which they compete on each other’s routes, retaliatory action is distinguished from this normal competitive process by the direct relationship between the entry event on the incumbent’s route and their response elsewhere.

8.222 The evidence discussed in paragraphs 8.191 to 8.198 and the references therein provides clear indications of actions of a retaliatory nature in the North-East and North-West of England. In particular, contemporaneous discussion of these actions in internal papers clearly show that these actions were considered as retaliatory responses to competitive incursions by rivals, and in some instances the objective of encouraging rivals to withdraw is explicitly set out. We note that we have seen no reference in these discussions to whether the actions would be profitable.

8.223 Arriva told us that the evidence showed that in many cases signals had not been understood or acted upon, and so the CC’s own evidence did not fit its theory of geographic segregation. It said that ‘Successful coordination would require clear, consistent signals that are well understood by all sides and which evidence shows have regularly been acted upon. Unclear and inconsistent signalling would make any coordination extremely difficult if not impossible and any coordinated equilibrium unstable.’

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68 Arriva response to the addendum to the provisional findings on geographic market segregation and operator conduct, paragraphs 4.1–4.5.
69 Stagecoach response to the addendum to the provisional findings on geographic market segregation and operator conduct, paragraph 3.2.
70 Arriva response to the addendum to the provisional findings on geographic market segregation and operator conduct, paragraph 3.3.
8.224 We note that despite signals not always being understood, the fact that these actions were taken shows that these operators had some expectation that they would be successful in dissuading rivals from entering their Core Territory.

8.225 Our assessment of geographic market segregation suggests that coordination is imperfect (ie covering areas that are broadly understood but are likely to have borders that are poorly defined—see paragraph 8.187). This can explain why signals are not always understood, and why in some instances we have observed coordination breaking down and operators competing for each other’s passengers.

8.226 In addition, the evidence that we have seen shows coordination that is broadly-based (ie covering a number of routes within each operator’s Core Territory). This can explain why, even when geographic market segregation is imperfect and operators misunderstand each other’s signals, coordination on the remainder of each operator’s area is able to continue. Given this, we do not agree that a necessary condition for geographic market segregation is that signalling is always successful.

8.227 Go-Ahead said that the CC had under-emphasized the fact that bus operators were legitimately frequently in contact with one another due to the context of the operational, business and political environment of public transport operations. It told us that there was no clear evidence to suggest that many of the contacts that the CC pointed to went beyond what would be expected in the normal course of business, and referred specifically to the information exchanges which were made in the context of discussions of the North-East Transactions, which it considered to be legitimate. It also told us that in terms of information exchange occurring at senior management level, as far as Go-Ahead was concerned this was only in the context of the Transactions, and such discussion would normally be expected in negotiations of this kind.71

8.228 We recognize that discussions take place between companies in the context of negotiations involving corporate transactions. However, as we discuss in paragraphs 8.200 and 8.201, we have seen evidence of communication that includes exchanges of sensitive information and details of operators’ intended strategies. These exchanges do not seem to us to represent normal commercial behaviour, even in the context of corporate transactions. Moreover, they are likely to have served to reinforce geographic market segregation.

8.229 FirstGroup told us that the nature and frequency of contacts between Arriva and FirstGroup in the North-West was markedly different from the contacts between Arriva and Go-Ahead in the North-East, and that the CC drew over-broad parallels between the nature and frequency of the bilateral contacts between operators in the two areas.72

8.230 A full explanation of the evidence on the extent of communication between Arriva and FirstGroup in the North-West is set out in Appendix 8.6. Discussions between Arriva and Go-Ahead in the North-East took place in a different context to discussions between Arriva and FirstGroup in the North-West and the frequency of contracts was less in the case of the North-West. Nevertheless there is evidence that senior managers within the two operators attempted to communicate regarding current registrations and possible retaliatory responses. We would not expect discussions of this type—recorded in FirstGroup’s competition compliance reports—to occur, and

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71 Go-Ahead response to the addendum to the provisional findings on geographic market segregation and operator conduct, paragraphs 2.7 to 2.10.
72 FirstGroup response to the addendum to the provisional findings on geographic market segregation and operator conduct, p2.
we remain concerned that these communications may have served to support geographic market segregation between the operators.

8.231 Arriva told us that ‘its purpose in any sale (and purchase) is to use assets as efficiently as possible. Market segregation is not a motive’. It said that no exchange of vehicles had taken place, and that there was no evidence that any exchange was intended to act as or interpreted as a signal.73

8.232 Go-Ahead told us that ensuring that the assets involved in a transaction were of similar value was an entirely rational approach to commercial negotiations involving a competitor, as Go-Ahead would not wish third parties to form the impression of there being commercial weakness on GNE’s part (ie if it were to be seen to ‘give away’ more than it was due to gain) and vice versa.74

8.233 As we note in paragraph 8.207, we recognize that asset sales may be normal business practice. However, the evidence that we have received raises concerns that the transactions in the North-East between Arriva and Go-Ahead have served to reinforce market segregation by adding clarity to the extent of each operator’s Core Territory, and reducing the extent of overlap between the operators. It appears likely that the other proposed transactions between Arriva and FirstGroup would have had a similar effect, had they come to fruition. In these cases, even though the asset sales did not take place, we conclude that they may have served to reinforce rivals’ understandings of geographic market segregation. We note a FirstGroup internal document suggesting that the transaction in the North-West might provide a signal to Arriva that FirstGroup did not want to get into a ‘tit for tat battle’ (see Appendix 8.6, paragraph 41).

8.234 We do not consider that a mutual balancing of the assets involved in a transaction is necessary to avoid third parties forming an impression of commercial weakness. Instead, what will matter is that the full market value of the assets sold is received in exchange for them. Notwithstanding this, we recognize that it is not necessarily the case that deals involving assets of the same value will never occur in the normal course of business. However, when seen in the light of the other evidence that we have received concerning competition between Arriva and Go-Ahead in the North-East, we conclude that this aspect of negotiations lends support to the idea that the transaction was intended to limit competition between the parties and in this way promote geographic market segregation.

The extent of geographic market segregation in the reference area

8.235 The evidence discussed in paragraphs 8.184 to 8.212 details a number of actions taken by Arriva, Go-Ahead and FirstGroup that are relevant to our assessment of geographic market segregation in the market for local bus services. In particular, evidence relating to the conduct of ANE and GNE in the North-East of England leads us to conclude that operator conduct has led to geographic market segregation in this area. We have also seen evidence of behaviour in the conduct of Arriva and FirstGroup in the North-West of England that is difficult to reconcile with competition on the merits. We have also observed evidence of Arriva retaliating to competitive incursions in Leicester, of Arriva and FirstGroup considering possible asset swaps [\[\#\]], and evidence that retaliatory actions were considered by FirstGroup in response to competitive incursions by Stagecoach in Glasgow, Yorkshire and Devon. Finally,
we have noted that Go-Ahead refers to retaliation in response to competition from FirstGroup in Plymouth.

8.236 We have not been given evidence of similar behaviour taking place outside these areas or involving other operators. However, as we discuss in paragraph 8.170, obtaining direct evidence of geographic market segregation is very challenging. Coordination is unlikely to be acknowledged or recorded by operators. The information provided to us by parties in response to our questionnaires and some of our information requests has not in all cases provided evidence of such behaviour even where we have subsequently found evidence that they apply.

8.237 As such, that we have not observed evidence of actions directed at promoting geographic market segregation taking place more generally in the reference area is not inconsistent with the possibility that instances of geographic market segregation may be more widespread. This is particularly the case because the conduct leading to geographic market segregation may take a number of different forms, some less explicit—and so potentially harder to detect—than others.

8.238 This leaves open the question of whether our findings on geographic market segregation—relating to the actions of specific operators in certain parts of the reference area—could be indicative of a wider pattern of behaviour. We explore this question in this section. We begin by considering whether conditions in the bus industry are such that coordination could take place in the absence of explicit behaviours on the part of operators to coordinate their actions. We then discuss the market structure and extent of entry and expansion that we observe in the local bus market, and what this suggests about the possibility that geographic market segregation may occur more widely. Finally, we briefly discuss the extent to which geographic market segregation might in principle apply to different types of operators.

Conditions for tacit coordination

8.239 The evidence relating to geographic market segregation that we have reviewed shows three of the Large Operators taking certain actions which we conclude were aimed at promoting geographic market segregation. However, this evidence is limited to certain areas, and we have not received evidence of such actions taking place in other parts of the reference area.

8.240 One explanation for this is that operator conduct is not causing geographic market segregation elsewhere in the reference area. A second explanation is the difficulty of finding relevant evidence even where coordination is taking place (see paragraph 8.170). However, we also note a third possible explanation (which we assess in this section)—that, in principle, coordination can be completely tacit, without any operators needing to take any explicit actions to establish geographic market segregation.

8.241 CC guidelines set out three key conditions that facilitate tacit coordination:

(a) First, the market has to be sufficiently concentrated for firms to be aware of the behaviour of their competitors, and for any significant deviation from the prevailing behaviour by a firm to be observed by other firms in the market.

(b) Second, it must be clear that it will be costly for firms to deviate from the prevailing behaviour; so costly that it will be in a firm’s interests to go along with the prevailing behaviour rather than seek to deviate from it.

75 CC3, paragraphs 3.62–3.64.
(c) Third, this type of parallelism can only be sustained in markets where there are relatively weak competitive constraints.

8.242 In Appendix 8.4, we evaluate whether these conditions for tacit coordination are likely to hold in the case of the supply of local bus services. As set out in that appendix, we have found that the conditions for tacit coordination in the form of geographic market segregation 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 segregation across areas, i.e., 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.

8.243 This suggests that while coordination might involve further actions on the part of operators (e.g., communication between rivals as set out in paragraphs 8.199 to 8.206), it does not appear that such actions would always be necessary for geographic market segregation to arise. Stagecoach suggested that ‘the fact that actual express communication took place suggests that tacit coordination could not be achieved; since overt communications clearly pose a greater risk from a competition perspective’. We disagree that this is necessarily the case. Uncertainty surrounding the exact boundary of each operator’s Core Territory (as discussed in paragraph 8.187) is likely to cause the coordination that operators are able to reach to be imperfect, and this creates a potential role for operators to take more explicit actions in order to reinforce geographic market segregation.

Local bus market structure and the extent of entry and expansion

8.244 We also considered evidence on the structure of local bus markets and the extent of entry and expansion, and what this suggested regarding whether competition in the reference area may be restrained by a more general pattern of geographic market segregation.

8.245 We found in Section 4 that local areas are, on average, highly concentrated, with only a small number of operators with significant shares of supply. We also found that although active throughout the reference area, it is uncommon for the operations of the Large Operators to overlap substantially. For example, in 70 per cent of Urban Areas only a single Large Operator has a share of supply of 10 per cent or more, and in only 25 Urban Areas (10 per cent) are there two or more of the Large Operators with a share of local bus services greater than 25 per cent.

8.246 Evidence on entry and expansion (set out in paragraphs 6.74 and 6.75) shows that the market structure is generally stable. The entry behaviour of the Large Operators is presented in paragraphs 6.89 to 6.102. We concluded that:

(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;

76 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 of a 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.
FirstGroup’s entry events have been concentrated on areas around Glasgow and have not been in competition with any of the Large Operators; and

National Express has not entered into any new area.

A number of operators told us that where operators did not choose to enter into other areas, this was due to a lack of profitable opportunities, although some pointed to examples of entry and expansion that had occurred. Their comments are set out in Appendix 8.3.

Although it is uncommon for the operations of Large Operators to overlap, there are a number of areas within the reference area where two or more Large Operators are present and where bus operators claim that there has been competition between large operators for many years. Arriva gave us the examples of Leicester, the 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 profitable.

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:

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

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’. 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

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77 Arriva’s response to CC’s Updated Issues Statement.
78 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.
79 FirstGroup said that the routes that did not face competition in Aberdeen had low demand.
80 FirstGroup said that between October 2009 and October 2010 it had seen its share of supply decline by 9.6 per cent.
question, in which case no profitable opportunity for expansion would have arisen.\textsuperscript{81}

\textbf{(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 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.

8.250 There are, however, examples where Large Operators have entered into head-to-head competition with one another, either by setting up new routes or by acquiring a smaller operator in an area where a rival Large Operator is active, as set out in Appendix 6.5, Table 3. For example, 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. 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 a minority shareholding in Ipswich Buses, which would have put it in direct competition with FirstGroup.\textsuperscript{82}

8.251 These examples suggest that there are occasions when certain Large Operators are willing to enter into each other’s respective areas of operation to take up a profitable opportunity. However, such examples are few in number and in the main we see that Large Operators tend not to enter new areas in direct competition with each other.

8.252 In addition to this descriptive analysis of market conditions, we also considered whether there was a straightforward statistical relationship between market structure and margins, which might indicate the existence of coordination or geographic market segregation. This test is detailed in Appendix 8.7. The results do not show evidence of general patterns of coordinated behaviours based on depot profitability in areas we have selected as potentially being vulnerable to coordination. However, as we set out in the appendix, the analysis required us to make strong assumptions regarding the local markets in which coordination is likely to occur, and we did not control in the

\textsuperscript{81} 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 [\textsuperscript{9}]. As a consequence, Arriva also introduced cost-saving measures in autumn 2009.

\textsuperscript{82} Go-Ahead response to issues statement.
analysis for any other determinants of profitability. As such, we do not attach weight
to these results.

8.253 We conclude that local areas are highly concentrated, with limited overlap between
the Large Operators. The market is generally stable, and in the main we see that
Large Operators tend not to enter new areas in direct competition with each other
(although there are examples of Stagecoach and Go-Ahead doing so). We see a
number of instances where Large Operators serve networks in close proximity to
each other, but where the extent of competition between them appears to be limited.

8.254 Such a pattern of high concentration and a stable market structure could be
explained by a widespread pattern of geographic market segregation. However,
barriers to entry (which are discussed in Section 9)—in combination with historic con-
centration in the industry—could also provide an explanation.83 We note that these
explanations are not necessarily mutually exclusive.

Geographic market segregation between other operators

8.255 In seeking evidence from operators’ materials to assess geographic market segrega-
tion, we have focused on the Large Operators. In particular, this is because the key
evidence that we received relating to geographic market segregation concerned three
of the Large Operators (Arriva, Go-Ahead and FirstGroup). We note that the evi-
dence that we received did not relate to either Stagecoach or National Express. In
the case of Stagecoach, we have no evidence of it considering or engaging in such
behaviour, and note that it has entered in direct competition with a rival Large
Operator on a number of occasions in the previous five years. Similarly we have no
evidence of National Express being involved in such behaviour, although we note
that it has little direct market contact with the other Large Operators and has not itself
sought to enter against any of them.

8.256 We considered in principle whether smaller operators might be less likely to be party
to geographic market segregation. We noted that larger operators have a greater
range of options for expansion from existing sites and are more likely to come up
against each other on different routes or in different areas given their size and geo-
graphic coverage. The benefits from avoiding competition could therefore be greater.
In addition, larger operators are more likely to have the ability and incentive to
engage in retaliatory measures to ‘punish’ an operator which enters against them
than would be the case for a smaller operator. The same reasoning might apply to
operators who are locally significant even if they are not multi-regional.

8.257 Smaller operators, on the other hand, might have limited resources to allow them to
engage in retaliatory conduct. The incentive to do so would be less as there are
fewer possible overlaps with other operators, so any benefits from a reduction in
competition on other routes would be less significant. As such, it appeared to us that
smaller operators will be less likely to be party to geographic market segregation.

83 Alternatively, in its response to the addendum to the provisional findings on geographic market segregation and operator
conduct, Arriva suggests that a lack of profitable opportunities for entry could provide an explanation, although we do not find
this to be a credible explanation for the lack of head-to-head competition that we observe in the reference area—see paragraph
8.96.
Conclusions on operator conduct and geographic market segregation

8.258 We conclude that competition between Arriva and Go-Ahead in the North-East has been diminished by their conduct, which has led to a degree of geographic market segregation of their respective operations in this area.

8.259 The evidence that we have seen indicates that this geographic market segregation has been reinforced through a variety of mechanisms, which have served to moderate or avoid competitive behaviour. This includes evidence of a readiness to incur the costs of retaliation that appears to have had the objective of deterring entry and reinforcing geographic market segregation; frequent bilateral contacts and discussion between Arriva and Go-Ahead which go beyond what we would expect in the normal course of business; and an exchange of strategic assets, the effect of which has been to extend the degree of geographic market segregation between Arriva and Go-Ahead by reaffirming each operator’s Core Territory and removing overlap between them.

8.260 While our finding is limited to the North-East, we have also observed more limited evidence of behaviour appearing to promote geographic market segregation taking place in some other parts of the reference area, in particular in areas of the North-West.

8.261 Obtaining evidence of coordination between operators is extremely challenging. We found that the conditions to facilitate tacit coordination are present across the reference area, and so explicit actions on the part of operators may not be required for geographic market segregation to be achieved. We are concerned that coordination of the sort of conduct that we have described in the appendices and that exacerbates geographic segregation may occur elsewhere and could do so in the future.

8.262 Therefore, we remain concerned that geographic market segregation may be a more widespread problem.

Exclusionary conduct

8.263 In paragraph 8.98 we found that the nature of head-to-head competition could mean that it might not be sustained. In these cases, operators may compete so as to ensure that their rival is more likely to exit, and may attempt to signal that entry is likely to generate a period of costly competition. Operators can engage in a spectrum of competitive behaviours from mild to more intense expressions of competition.

8.264 We have considered whether there is a distinct category of behaviour that may be identified as having a further AEC in that it excludes rivals from the market.\(^{84}\) We received or are aware of allegations that certain operators have acted outside the scope of normal competitive practices. The terms used to describe this behaviour are numerous, including ‘unfair’ and ‘aggressive’. As noted in paragraph 6.107 and Appendix 6.6, the OFT has received a considerable number of allegations of operators behaving in this way, with most allegations being about predatory conduct. Indeed, the volume of allegations was one of the reasons for the OFT’s market study and why it made a reference to the CC (see paragraph 1.9). During our investigation, we have also become aware or heard of a number of other cases of operator conduct

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\(^{84}\) We are not equating exclusionary conduct with actions which are illegal under the 1998 Act, rather we are looking at any conduct which has the effects described.
which were alleged to have been exclusionary, including allegations from several operators. These are set out in Appendix 6.6.

8.265 We therefore sought to investigate whether it was possible to identify a distinct category of operator conduct that had the effect of increasing the probability of rivals exiting or retrenching from the market (hence reducing competition), or reduced the likelihood of future entry or expansion against the operator by potential rivals (by creating a reputation for aggressive responses to entry). This ‘exclusionary conduct’ would need to be distinguished from normal processes of competition within the context of the industry, which may involve some operators failing and exiting as a result of competition.

8.266 We investigated this theory in a number of ways, by looking at allegations of exclusionary conduct by operators, by considering past examples of aggressive competition as shown in the case studies, and considering evidence supplied by the OFT, Traffic Commissioners, local bus operators, PTEs and LTAs in relation to past accusations of aggressive conduct which might be considered exclusionary.

8.267 We asked local bus operators and some third parties where the boundary between robust and unfair competition lay. The responses are summarized in Appendix 6.6, paragraphs 26 to 31. As noted in paragraph 6.117, several of the Large Operators told us that while exclusionary conduct may have occurred in the past, this practice had now largely disappeared, and that there were legal boundaries between robust competition and exclusionary conduct. Some of the Large Operators referred to their compliance procedures and others commented that they would compete robustly but legally. However, various other operators referred to sharp competitive practice between different bus operators.

8.268 The incidence of extreme competitive behaviour appears to be considerably less than it was in the years immediately after privatization of the industry. This may be in part because some of this conduct appears to be covered by the Chapter II prohibitions of the 1998 Act and/or Article 102 of the TFEU (which did not apply immediately post-privatization). We have not considered whether these Acts apply to the issues we are describing as the CC is not the body that enforces such provisions. In addition, the Traffic Commissioners play a role in regulating some other aspects of behaviour, as outlined in paragraphs 12.53 to 12.62. This in particular relates to activities which are potentially dangerous to road users and passengers, such as overbussing, leapfrogging, obstructing bus stops, etc. Nonetheless, we received evidence of such practices still occurring during the course of this investigation.

8.269 While there are instances where competitive conduct appears to have gone beyond the boundaries of ‘fair’ competitive practice, within the context of this industry where competition can take forms likely to have the effect of causing rivals to exit, it has not been possible for us to define a boundary between behaviours that distinguish beneficial competition from exclusion. This distinction is challenging in conceptual terms in the context of an industry where there are factors that can render head-to-head competition unsustainable even where firms engage in behaviour that is rational in the short run. New entry may be expected to trigger a response by the incumbent competitors and to be followed by a period of intense competition, and these competitive responses can have the effect of excluding rivals, whether or not that is the intent.

8.270 In addition, some incumbents argued that their behaviour at the time or following entry was intended to achieve other primary objectives than to compete, eg in King’s Lynn it was argued that the fare reduction and frequency increases implemented by FirstGroup were aimed at increasing modal shift.
8.271 Undertaking assessments of exclusionary behaviour at an aggregate level is also difficult due to the need to assess the particular circumstances of that instance and the difficulties in confirming the facts put to us, for example in establishing the nature of actions and the reasons for these actions. However, we have heard from the Traffic Commissioners that such events have taken place and that VOSA officers have witnessed particular incidents—see Appendix 6.6. Each complaint we received related to a specific route and a specific operator. As routes and market circumstances differ, an assessment of the conduct of local bus operators in response to entry would require a detailed analysis of demand and costs at route level. This analysis is particularly difficult at times of change, ie in the months following entry.

8.272 However, we note our finding that the way in which operators compete can result in processes of competition that lead to the exit of rivals and so diminish competition. This conduct might also be deliberately employed to reduce competition, for example through creating a strategic barrier to entry by acquiring a reputation for tough responses to entry events. Within this finding, we include more extreme aspects of conduct which are most likely to bring about this AEC, and note that any or all rivals (including entrants and incumbents) can behave in ways which have this effect.

8.273 The four cases described in paragraphs 6.83 to 6.87 and the review of strategic options outlined in paragraph 6.88 illustrate the ease with which a sufficiently well-resourced entrant can impact on the financial viability of an incumbent by competing head-to-head with its most lucrative services. Against an incumbent with limited resources, it is possible that incoming and expanding operators can weaken them to a point where they may need to withdraw or seek a sale. It is possible for an entrant to use similar tactics to attempt to distort a sales process, or to facilitate its own acquisition of the incumbent operator.

8.274 We make no conclusions on whether the cases referred to in paragraphs 6.83 to 6.87 were examples of competition on the merits of the operators’ offers or were motivated by an intention to impact on the sales process of incumbent operators. As noted above, it is not possible to generalize about whether conduct in such cases is an example of beneficial competition or anti-competitive in its effect, but we note that strategies are open to operators which can exclude rivals and distort sales processes in favour of a competitor. However, in other cases, there have been examples of distress sales of municipal operators caused by a period of intense competition from a large operator, as detailed in paragraph 2.41, as well as the circumstances in which the Darlington Transport Company went into administration in 1994, as described in the MMC report on bus services in the North-East.

8.275 Nonetheless, there are some aspects of competitive conduct which can be distinguished in that rather than serving the purpose of improving an operator’s offer relative to their rivals (such as lowering price, improving the quality of service or increasing the frequency of operations), they are instead undertaken to diminish a rival’s ability to offer its service. We refer to this category of conduct as ‘cheap’ exclusion, and it can be defined as actions that damage the service of a rival and do not provide direct benefits to passengers.

8.276 Examples of this ‘cheap’ exclusion that we have heard about include: obstruction of a rival’s services, for example through deliberately blocking or delaying their services on the road; preventing them from using bus stops and stands; intimidating drivers;

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85 The supply of bus services in the north-east of England, MMC, August 1995.
86 The term ‘cheap’ does not imply that the consequences are unimportant. The term ‘cheap’ derives from the economic literature where it can refer to actions which have little or no positive value (such as where they do not give rise to efficiency improvements that might feasibly benefit consumers).
causing damage to a rival’s vehicles, depots or other facilities; removing rival operators’ publicity and timetables; providing misinformation about a rival’s services to passengers; imitating a rival (such as copying its livery); and guiding passengers at a bus stop away from boarding a rival’s services. Some examples of the use of these types of action are described in Appendix 6.6. We have no indication that any bus operator has endorsed any such conduct by its employees in recent years (and many told us that they would not tolerate such behaviour), although we have heard allegations of its occurrence in relation to periods of inter-operator competition, including the examples in Appendix 6.6.

8.277 Cheap exclusion, where it occurs, contributes to competition not being sustained. It also contributes to the perceived risks and costs of entry as an incumbent operator might utilize such tactics. Hence, it can act to restrict the constraint from potential competition and new entry. This behaviour is by no means universal. However, despite cheap exclusion being to some extent subject to the powers of the Traffic Commissioners and other legal constraints (eg on vandalism), incidents are still observed.

87 For example, National Express told us that it would not consider such practices a prevalent feature of the market in the West Midlands; see its response to the provisional findings in paragraph 2.5b(v).
9. **Barriers to entry and expansion**

**Introduction**

9.1 In this section, we consider whether there are barriers to bus operators entering a local area in competition with an existing operator (ie barriers to entry where an operator is establishing a new local operation), or barriers to existing bus operators expanding their services on existing routes or into nearby local areas (ie barriers to an expansion of operations from existing facilities). Barriers to entry protect incumbent operators by reducing the competitive constraint posed by new entry, while barriers to expansion reduce the competitive constraint posed by potential competition. Our consideration of barriers to entry and expansion complements the discussion in paragraphs 8.103 to 8.165 where we identify that the threats of entry and potential competition can, in principle, act as a constraint, preventing incumbent operators from exercising market power. The ability for operators to exercise market power is less likely where entry or expansion is easy, ie barriers are low or absent, provided that such entry and expansion is sustainable.

9.2 We consider a number of characteristics of local bus markets to determine whether they give rise to barriers to entry and expansion. These characteristics are:

- costs of entry and expansion (see paragraphs 9.7 to 9.32);
- incumbent reactions to entry and expansion (see paragraphs 9.33 to 9.57);
- strategic retaliation in response to new entry or expansion (see paragraphs 9.58 to 9.65);
- network and multi-journey ticketing effects (see paragraphs 9.66 to 9.127);
- charges for and access to bus stations (see paragraphs 9.128 to 9.161);
- access to depot facilities (see paragraphs 9.162 to 9.173);
- economies of scale (see paragraphs 9.174 to 9.187);
- regulation (see paragraphs 9.188 to 9.195); and
- local knowledge and effective local management (see paragraphs 9.196 to 9.202).

**Definition of barriers to entry**

9.3 Barriers to entry are defined in *Market Investigation References: Competition Commission Guidelines, CC3* (paragraph 3.22) as:

features of the market that may prevent or restrict firms from exploiting profitable opportunities in a market and hence enable existing suppliers to raise prices above costs persistently without significant loss of market share. Some barriers are described as ‘natural’ or ‘intrinsic’ in the sense that they are a function of the technology, production methods or some other factor necessary to establish an effective presence in the market. Some are ‘regulatory’, such as rules designed to provide safety, or other types of consumer protection that may make it difficult for new firms to develop products. It should be noted that the concept of regu-
lation in this case is broader than the conventional sense and includes things such as intellectual property law, the planning regime, voluntary or compulsory standards and codes of practice for example. Other barriers, termed ‘strategic’, are the result of existing firms in the market acting with the specific intention to deter entry or expansion.

9.4 Barriers to entry need to be assessed in the context of the industry in which they arise. The local bus market, in most areas, is mature and passenger demand overall has been static since 1996/7 after a long period of decline (see Figure 2.2). While bus use is growing in some areas, in many areas it is static or declining. Barriers to entry and expansion are likely to be more significant in a static or declining market than in an industry where demand is growing rapidly.1 Nor is the bus industry characterized by dramatic innovations which substantially change the nature of service provision. Where product cycles are short, barriers to entry may not have a lasting effect; however, in bus services, innovations and improvements are incremental in nature.

Evidence for the existence of barriers to entry and expansion

9.5 Before assessing individual barriers to entry and expansion, we note the evidence which indicates that barriers of some kind exist in the supply of local bus services.

9.6 In summary, we find that head-to-head competition provides a greater constraint than the constraint from potential competition and new entry, and because this indicates that these are imperfect constraints, it indicates that barriers to entry and expansion exist. The sources of empirical evidence which lead to this conclusion are:

(a) The performance concentration analysis at the route level shows that the number of competitors present on a route affects the frequency of service on a route. On average, an additional competitor on a route results in a frequency of service that is 12 to 15 per cent higher. This analysis is set out in detail in Appendix 7.1. This analysis shows that incumbent operators that do not face head-to-head competition have been able, on average, to maintain services that are less frequent than would be the case if they faced head-to-head competition.

(b) In addition, there are many examples of incumbent operators reacting to new entry once it has occurred. These examples are set out in Section 6 (see particularly paragraphs 6.105 to 6.142). The fact that incumbents have only reacted, once entry has occurred suggests that in these instances the threat of entry was insufficient to constrain the incumbent operator to the same extent as head-to-head competition.2

(c) Our consideration of profitability (see paragraph 10.90) shows that operators representing a substantial part of the market have earned profits persistently above the cost of capital on a national basis. This indicates that competition may not have been wholly effective across the reference area and that barriers to entry and expansion exist.

1 CC3, paragraph 3.21, ‘For instance, if growth in demand is likely to be large and/or rapid, then barriers to entry are less likely to have a lasting effect’.

2 There are of course examples where incumbents have not reacted to entry, which could be because the incumbent has already ensured that their offer is as effective as can be, or because they regard the particular entry event as insignificant or unthreatening.
Costs of entry and expansion

9.7 There are a variety of costs involved in establishing and expanding local bus operations. The extent to which the costs associated with entry and expansion are ‘sunk’ is critically important for the assessment of barriers to entry. In circumstances where sunk costs account for a significant proportion of the total costs of entry or expansion, the risks involved in entry are much higher. This will inform the decision of whether to enter a market; a prospective entrant will need to weigh up the scale of the potential sunk costs against the expected returns that will arise if entry is successful. Small-scale entry where only a limited pay-off is expected will justify only a low level of risk and/or a low level of sunk costs. Larger-scale entry which is expected to be significantly profitable will justify higher sunk costs before such risks are likely to deter entry.

9.8 We first consider whether any costs of entry or expansion are likely to be sunk. We then consider whether, and if so how, these sunk costs vary depending on the method and scale of entry and expansion.

Costs of bringing a route to maturity

9.9 We first consider the cost of bringing a route to maturity. Operators told us that when new services were introduced, it took time for passengers to learn about the service and for revenue to build up. This lead time implies that there is likely to be some period when a new service is introduced where revenues are likely to be below their long-term level, and the new service could fail to cover its costs for a period. When the route matures, the route should cover its allocated fixed costs and contribute to the depot’s overall profitability. Any non-recoverable costs incurred during the period of loss-making operation represents a sunk cost as such costs cannot be recovered on exit. Similarly, if services are expanded such as increasing operating hours or frequency of service, passenger reaction (and hence revenue increases) could be a delayed. Stagecoach told us that every time it increased the frequency on a route, there was a step change in costs, while revenue took time to build up. This indicates that there is also a sunk cost in expanding or redeploying operations and is relevant to the constraint from potential competition.

9.10 Operators told us that the success of a new route is difficult to predict. Most of the Large Operators and one Mid-Sized Operator told us that the time taken for a new route to achieve profitability varied according to a number of factors, including whether the service generated more bus journeys and grew patronage, demographics, frequency, PVR requirements and whether the service was peak or off-peak.

9.11 Arriva said that as a broad rule of thumb it would expect a route to be covering its variable, semi-variable and fixed-cost allocation after 12 months and to have seen growth towards profitability since introduction. FirstGroup told us that typically a route would be targeted to become profitable within [X] months of operation. Stagecoach said that when a route provided new travel opportunities, it might take three years for it to become profitable (hence the Kickstart and Bus Route Development Grant

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3 By ‘sunk’ costs, we mean the costs incurred upon entry that cannot be recovered fully upon exit, for example because the product or knowledge that has been purchased cannot be used for other purposes and cannot be successfully traded.

4 The categories of costs we assess are based on the costs involved in entry and expansion identified by operators in their responses to our questionnaires.

5 Stagecoach, FirstGroup, Arriva, National Express, Rotala.

6 FirstGroup.

7 Arriva.
schemes for new routes). National Express stated that a completely new route operating in an area where there was no tradition of bus use could take up to 18 months to reach a stable level of patronage. Other operators, including Go-Ahead’s subsidiaries, gave estimates of up to two years, although NCT said that the new routes it had started had been profitable from day one. One Small Operator told us that a new service took a minimum of six months, and sometimes a year, for the revenue to build to a point that it covered the costs of operation. Another Small Operator, [ ], told us that there was often a period of loss-making operation on a new service, while its performance reliability was monitored, that there was no guarantee that it would be successful and that these sunk costs could bankrupt a Small Operator.

9.12 Evidence we received from Large, Mid-Sized and Small Operators indicates that the time taken by a new service to reach profitability can be much greater if it is launched in competition with existing services. We found that the extent to which incumbents react, and the impact these have on the entrant, in part depend on the degree of overlap between the two operators’ services:

(a) Several of the Large or Mid-Sized Operators noted that the key factor in determining how quickly a route reached profitability was the demand it was able to attract, and noted that whether a route was launched in head-to-head competition with another operator would affect this.

(b) Arriva told us that if a route was already served by another operator, the quality of service delivery of the incumbent, particularly in respect of punctuality and reliability, and any response from the incumbent operator to competition would affect how long it took for the incoming operator to become profitable.

(c) Stagecoach told us that new routes launched in Sheffield in competition with another operator had taken up to three years to become fully profitable (ie cover allocated operating company costs); that a route launched in Barnstaple in competition with FirstGroup took three years to cover its direct costs; and a new route launched in Oxfordshire in competition with the Oxford Bus Company had been withdrawn after nearly three years of making a negative contribution to depot costs.

(d) FirstGroup provided an example of a route it had launched between [ ] and [ ] which was already served by another operator and had failed to become profitable.

(e) [ ]

(f) In relation to an ongoing period of competition with Veolia (see Appendix 6.4—Cardiff, paragraphs 90 to 105), Edwards Coaches said that on the two routes together [ ].

(g) Rotala, after 12 months of competition, decided to withdraw from its commercial services in Worcester as it was still losing around £[ ] to £[ ] per week; see Appendix 6.4—Worcester, paragraph 71.

9.13 Several parties criticized the notion of the costs of bringing a route to profitability as a sunk cost that forms a barrier to entry. They variously argued that these costs were

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8 McGill’s.
9 Stagecoach, FirstGroup, Rotala, Lothian Buses.
10 National Express (paragraph 4.16), FirstGroup, Arriva (paragraph B3-7), responses to provisional findings.
often low or absent,\textsuperscript{11} that where entering in competition with an existing service there was already an established base of customers (hence there was no lag while demand was built up),\textsuperscript{12} and that initial operating losses are common for any entry decision in any industry and would normally be treated as part of the overall costs and revenues to be evaluated in deciding whether there is a profitable entry opportunity.\textsuperscript{13} In some cases there may be a commercial miscalculation which results in a route taking a long time to reach profitability, or not reaching profitability, rather than this demonstrating the existence of a barrier.\textsuperscript{14} FirstGroup\textsuperscript{15} told us that the extent of such losses, based on its commercial experience, were very small,\textsuperscript{16} that losses would in any case be limited to 56 days as an operator could deregister a loss-making service, and that the number of entry events observed was not consistent with there being such a barrier to entry.

9.14 We acknowledge that the size of this barrier is variable and in some cases the costs of bringing a route to profitability may be low in absolute value terms (for example, if there is an accommodating reaction from the incumbent operator such as removing some services). However, the barrier arises from a potential entrant’s perception of the risk that such costs could arise and not be recovered, and the fact that the extent of such costs will generally be unknown, particularly where these depend on the reactions of incumbents. It was put to us that operators can avoid such costs by cancelling their service registration\textsuperscript{17} but this is an action that would only be taken in reaction to the costs arising.

9.15 We do not agree that such costs are part of the normal evaluation of whether a business opportunity is profitable and hence irrelevant to the consideration of barriers to entry. These costs will be incurred by an entrant, not the incumbent, are not recoverable on exit, and as such represent a barrier to the entrant. However, we recognised that entry on a significant scale on an existing route could initially lead to over-capacity that might result in losses for both the new and incumbent operators depending on the reactions of the incumbent and whether either operator would reduce capacity.\textsuperscript{18} Such over-capacity will most likely either be temporary until capacity is reduced or parties will engage in competitive practices such as described in paragraphs 9.33 to 9.57.

9.16 Overall this evidence suggests that a new service may take a considerable amount of time (in some cases, several years) to achieve profitability, when launched in competition with an existing service, during which time some costs are irretrievably incurred. The extent of initial losses, and hence the timescale over which a route becomes profitable, will also depend on the competitive reaction of incumbents. There could also be uncertainty of when or whether the route will become profitable and the extent of sunk costs incurred. This uncertainty, and the possibility that these costs may turn out to be relatively high, gives rise to potentially higher financial risks of entry or expansion. The ability of an operator to take advantage of any opportunities for entry or expansion will therefore be affected by: \(a\) the financial strength of the entrant; and/or \(b\) the entrant’s appetite for, or aversion to, the associated financial risks. Consequently the threat of potential competition from

\begin{itemize}
\item \textsuperscript{11} National Express response to provisional findings, paragraph 4.17, Go-Ahead response to provisional findings, paragraph 4.5.2, Arriva response to provisional findings B3-6 and B3-9.
\item \textsuperscript{12} National Express response to provisional findings, paragraph 4.19.
\item \textsuperscript{13} Lothian response to provisional findings, paragraph 9.3, Arriva (paragraph B3-7).
\item \textsuperscript{14} Stagecoach response to provisional findings, paragraph 4.12.
\item \textsuperscript{15} FirstGroup response to provisional findings, paragraph 3.19.
\item \textsuperscript{16} FirstGroup said that the extent of such costs was, based on its commercial experience, very limited—with an average for FirstGroup of around [\(\$\)] of direct losses within a 56-day period (ie less than [\(\$\)] a day) on routes that were subsequently withdrawn (see response to provisional findings, paragraph 3.19b).
\item \textsuperscript{17} Lothian response to provisional findings, paragraph 9.3, National Express paragraph 4.16, FirstGroup, paragraph 3.19.
\item \textsuperscript{18} Stagecoach response to provisional findings, paragraph 4.12.
\end{itemize}
smaller operators with limited resources and a high dependence on the financial success of an entry decision will generally be a lesser constraint than the threat of potential competition from larger and stronger operators nearby.¹⁹

**Other sources of sunk costs**

9.17 We considered whether there were other substantial sunk costs associated with entry. In general, operators told us that the other sunk costs of entry were low. Stagecoach, FirstGroup, Arriva and National Express all stated that many of the costs identified would not be sunk in practice (such as the costs to fit out a depot) and that where there were some sunk costs these were not material. Go-Ahead said that sunk costs were low for small or medium-sized entry, although costs could be greater in relation to larger-scale entry, but it said that the sunk costs would be small in comparison with the £1 million to £1.5 million in annual revenues that could be achieved on a single high-density urban route. Stagecoach also noted that some elements of these sunk costs were also incurred by incumbent operators on an ongoing basis (eg marketing, or recruitment of replacement drivers), and to this extent new entrants would not be competitively disadvantaged relative to incumbents.

9.18 Based on the evidence collected from the parties, we consider below the following other potential sources of sunk costs of entry:

(a) driver training (paragraph 9.19);

(b) marketing and vehicle branding (paragraphs 9.20 to 9.22);

(c) bidding costs of tendered services (paragraph 9.23);

(d) the costs of establishing an operating base (paragraph 9.24);

**Driver training**

9.19 A new entrant may need to recruit drivers, and train them to qualify for a PSV licence to enable them to operate the proposed services. Estimates of the cost, per driver, for new drivers, were of the order of approximately £2,000 to £4,000 per driver.²⁰ Such costs are likely to be sunk. In relation to specific costs, National Express said that a trained driver could expect to operate services generating revenue in excess of £50,000 per year, and a one-off upfront driver training cost of £2,000 to £4,000 was not a barrier in comparison to this. If qualified drivers were recruited from other operators, training costs were likely to be much lower. In addition, Stagecoach told us that many operators did not have formal training programmes, in which case such costs would be lower.

**Marketing and vehicle branding**

9.20 A new entrant may want to publicize its new services and brand its vehicles. We make the distinction here between ongoing marketing costs and the marketing costs associated with the launch of a new entrant’s services and brand. We received a

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¹⁹ The strength of potential competition as a constraint between larger operators will also depend on any relevant aspects of geographic market segregation which might weaken this constraint, see paragraph 11.48.

²⁰ [x] and [x] told us that costs were around £2,000 per driver. [x] told us that driver training costs were around £3,000–£4,000 per driver. In our calculations of profitability (see Appendix 10.3), average costs were identified at £[x] for Stagecoach, £[x] for Arriva, and £[x] for FirstGroup.
number of estimates for these types of costs. [●]; and an estimate that £10,000–£20,000 is probably required to market a completely new route (ie one not currently operated by any operator). There is a high degree of variability in these estimates because the nature and scale of these expansions can be very different. Arriva said that marketing costs and training costs were not substantial; it said that as an example, for its Maidstone depot, each accounted for only 0.4 per cent of total cost.

9.21 If an operator is replicating an existing route, marketing costs may be lower as passengers are already aware of the service. Such costs are likely to be partly sunk, as route-specific marketing cannot be easily transferred to other routes or to other operators on exit. We note that some ongoing marketing costs are also likely to be incurred by existing operators.

9.22 In contrast, the acquisition of vehicles themselves is unlikely to be a sunk cost due to the existence of a second-hand market for vehicles.

**Bidding costs for tendered services**

9.23 One means of entry into commercial services is to establish a new operation based on gaining tendered contracts so as to provide a base of secured work for a period of time. There will be costs involved in researching and preparing bids to operate supported services. These costs will be sunk if the bid is unsuccessful. If a bid is successful some of these costs might be built into the bid and hence recovered, but this is likely to reduce the competitiveness of the bid. We only received one quantitative estimate of these costs, of approximately £5,000 to bid for a new tendered service contract. However, several Large Operators told us that in their experience bidding costs would be substantially less than this amount, and one Large Operator told us that bidding work would be carried out by existing staff. While these costs are relevant to entry into supported services, they similarly apply to existing operators bidding for new or renewed contracts.

**Operating base**

9.24 There are several different types of depot or operating base that could be utilized by a new entrant. Options are explored in more detail in paragraphs 9.162 to 9.173, but we note here that decisions on different types of operating base can impact on whether or not sunk costs are incurred:

- Renting a small- to medium-sized depot. If an entrant chooses to establish a depot, it will need to buy, build or rent a depot facility. Whether or not these costs are sunk will depend on the notice period required by the rental contract; it may be that rental payments can be terminated easily if the operator chooses to withdraw, but it may have liabilities for ongoing rent. One Large Operator told us that its leases did not involve long-term commitments. The cost of renting a depot was estimated by one Large Operator to be £[●] to £[●] per year, while another told us that it rented some depots for £15,000 to £20,000 per year.

21 National Express told us that this spend would not be required for every new route.
22 [●] and Stagecoach.
23 [●] and Stagecoach.
24 Stagecoach, National Express and Arriva.
25 Arriva.
26 FirstGroup.
27 National Express.
28 FirstGroup.
29 Arriva.
Converting a rented outstation to bus usage. Instead of using a new depot, an operator could use an outstation linked to an existing depot facility. Alternatively it could subcontract maintenance to local suppliers and refuel at petrol stations. In these cases, the operator will require little more than a parking site and some offices. Several Large Operators told us that the sunk costs in this method of entry were likely to be nil or very low. We received limited specific estimates of these costs but one Large Operator (Stagecoach) told us that the costs would depend on the nature of the facility, and if the facility involved only parking, the costs would be zero, while another (Go-Ahead) told us that it had recently incurred a cost of £30,000 to convert an engineering facility to bus usage.

Establishing a new depot. Alternatively, an operator might choose to establish a new purpose-built depot. There may be sunk costs in designing the depot, obtaining planning permission, and construction/converting to bus depot usage. One estimate was of £\(\times\) to fit out a depot site and make it operational, and we also received various estimates of construction costs (of which at least a portion is likely to be sunk), ranging from £\(\times\) to £\(\times\). FirstGroup told us that depot establishment costs were sunk only to the extent that they could not be recovered by sale of the underlying assets in case of exit, and National Express told us that the vast majority of these costs could be recovered upon exit. For example, some land and building costs might be recovered and even some fit-out costs might be covered within the realized value of an asset if the depot were sold as a going concern or for use as a depot to non-local bus operators. Arriva told us that it did not involve a high degree of capital expenditure to remove and replace any plant and equipment used to fit out a depot, and that some depot facilities were portable, indicating that costs were not sunk if upon exit the depot facilities could be used in another area. Stagecoach told us that at least a proportion of the construction costs were likely to be sunk, unless the depot could be sold for an alternative use (bus, coach, haulage, etc).

Sunk costs and scale of entry and expansion

The nature and level of sunk costs will vary depending on whether we are considering new entry or expansion, and on the scale of the entry or expansion.

An operator with spare parking capacity at an existing depot (or parking facility) in the area will not need to incur the sunk costs associated with establishing a new depot or renting new depot/parking facilities. Thus, small- or medium-scale expansion would avoid the cost of developing these facilities, while larger-scale entry would probably require additional facilities. Entry costs for a new entrant or a capacity-constrained existing operator will vary with scale, as small-scale entry may be possible with outstations or parking facilities with outsourced supporting functions. For large-scale entry or for significant expansions, the operator is likely to need to develop a new depot facility. The fact that large-scale operators appear to choose to develop a depot suggests that they consider it to be the best way to provide services on this scale. Three Large Operators told us that entering on a small scale would reduce

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30 Stagecoach also told us that additional land could be rented at existing facilities in some instances.
31 Stagecoach, Arriva, National Express.
32 Stagecoach. FirstGroup also told us that there might be some sunk costs associated with establishing a new depot.
33 The £\(\times\) refers to FirstGroup’s depot in Cardiff where it entered and expanded between 2005 and 2009. Stagecoach also identified that there might be these sorts of sunk costs involved.
34 Go-Ahead provided one example of construction costs of £\(\times\); Stagecoach provided examples of construction costs ranging from £\(\times\)–£\(\times\); and FirstGroup told us that construction costs for depots of approximately 100 buses would be in the range of £\(\times\)–£\(\times\).
35 National Express told us that it was possible to enter on a large scale without any large upfront depot costs being incurred as there were a range of business models available, with some being at very low cost.
the risk of entry, as it involved fewer sunk costs, and operators could then subse-
quently expand incrementally. 36

9.27 Existing operators may also be able to redeploy their existing drivers and vehicles to
facilitate some expansion if this is on a relatively small scale, and so avoid some of
the sunk driver training costs (and in the event of exit from a route may be able to
redeploy drivers to services elsewhere in the area). In comparison, a new entrant into
an area would have to incur these costs.

9.28 The costs associated with marketing the launch of a new route, branding vehicles,
bidding for new tendered services, and in bearing the costs of the initial losses until
routes are profitably established appear likely to be incurred by any operator wishing
to launch a new service, regardless of whether they already have facilities in the
area. These will vary in line with the scale of entry or expansion. All operators will
bear a similar cost in making a bid for a tendered contract.

9.29 This indicates that sunk costs are likely to be more significant for large scale entry
and for de novo entry rather than expansion from an existing base.

Conclusions on sunk costs

9.30 We conclude that there are some sunk costs of entry and expansion in local bus
service operation. These costs must be set against the expected return an entrant
can make, the uncertainty over the reactions of an incumbent rival operator and the
timescale within which these costs can be recovered.

9.31 The category of sunk costs to which we attach most significance are the losses
involved in bringing a route to profitability. These losses will depend on the
competitive reaction of rivals, and could mean that this period could extend for a long
time or that the services never achieve profitability. Because the extent and duration
of losses will be uncertain (and could be substantial), the possibility of such losses
will be a significant consideration for any operator contemplating entry or expansion.
Sunk costs are likely to be higher with larger-scale entry or expansion, and are likely
to be higher in relation to new entry than to expansion by an existing operator in the
area.

9.32 Other aspects of sunk costs include driver training, marketing, bidding costs and
developing a new operating base. However, these costs are relatively low and the
element which is sunk can be limited. We have received no submissions from any
operators in the industry that the sunk costs of entry and expansion (other than the
costs of developing a new route) form a significant barrier.

Expectations of post-entry competition and incumbent reactions to entry and
expansion

9.33 Incumbent reactions to entry and the intensity of post-entry competition can be con-
sidered as potential barriers to entry, CC3 (paragraph 3.22) states ‘Other barriers,
termed ‘strategic’, are the result of existing firms in the market acting with the specific
intention to deter entry or expansion’. The CC’s and OFT’s Joint Merger Assessment
Guidelines, paragraph 5.8.8 says ‘…in a market characterised by low barriers to
entry and/or expansion, entrants may nevertheless be discouraged from entry
by…the credible threat of retaliation by incumbents’. The OFT similarly says:

36 Stagecoach, FirstGroup and Go-Ahead.
An undertaking contemplating entering a market weighs up its expected profit from being in the market with the expected sunk costs of entering. Expected profits from being in the market may depend on how the entrant expects the incumbent to react when it enters the market: the potential entrant might believe that the incumbent would, for example, reduce prices substantially if it entered and so reduce the prospective profits available. While low prices are generally to be encouraged, if a new entrant expected an incumbent to respond to entry with predatory prices, this could deter entry. For example, if an incumbent has successfully predated in the past, it may have secured a reputation for its willingness to set predatory prices.

**Assessment of market power (December 2004), paragraphs 5.24 and 5.25.**

9.34 In the event of entry on a route which increases the total supply of bus services on the route, an incumbent operator may, rather than accommodating this, have an incentive to adopt behaviours which could have the effect of enhancing the entrant’s costs or reducing its revenues, eg substantial targeted fare cuts, increases in frequency or selective adjustment of service timings. More generally, an incumbent may indicate that it would impose ongoing costs on the entrant or reduce its revenues, which, if the continuation of such behaviour by the incumbent appears credible, could lead the entrant to conclude that it would be most profitable to withdraw.

9.35 Alternatively, when faced with imminent entry (eg when registration of a competing service has been notified), an incumbent operator may seek to deter this entry by signalling to the entrant that it would not make a profit if it did enter and would incur losses in the short-run because of aggressive competitive actions of the incumbent. Such behaviours would be likely to damage the profitability of the incumbent and so it would need to consider carefully whether such strategies would be profitable in the long run. The incumbent operator might then recoup these losses through profits in the longer term, once its rival is excluded, if further entry is deterred.

9.36 Examples of the ways in which incumbent operators respond to entry and expansion are outlined in paragraphs 6.105 to 6.142. Some of these responses can be perceived by the affected party as extreme or unfair. Accusations have been made of predation, as discussed in section 6. In paragraphs 8.263 to 8.277, we also address the question of whether any of this conduct can be considered as ‘exclusionary’. While most forms of competition deliver benefits to customers, such as through lower fares or increased frequency, even if the effect may eventually be the exit of a competitor, some forms of conduct do not do so. Instead they are designed with the primary intention of impeding the ability of a rival to deliver its service. This has at times emerged as a competitive tool and a response to entry; some examples are covered in Appendix 6.6, paragraphs 12 to 25. Examples of such practices include: obstruction of a rival’s services, for example through deliberately blocking or delaying their services on the road; preventing them from using bus stops and stands; intimidating drivers; causing damage to a rivals’ vehicles, depots or other facilities; removing rival operators’ publicity and timetables; providing misinformation about a rival’s services to passengers; imitating a rival (such as copying its livery); and guiding passengers at a bus stop away from boarding a rival’s services. We refer to such conduct as ‘cheap exclusion’, defined as actions that damage the service of a rival and do not provide direct benefits to passengers, and discuss this in paragraphs 8.275 to 8.277. We find that cheap exclusion, where it occurs, can contribute to

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37 An alternative response which would have a similar effect would be responses of retaliation on other routes, see paragraphs 9.58–9.65.
38 See paragraphs 6.107–6.112.
competition not being sustained, and contributes to the perceived risks and costs of entry as an incumbent operator might utilize such tactics. However, we also recognize that it is possible for the entrant to adopt such tactics against an incumbent.

9.37 Reactions to entry can have the effect of creating a costly period of tough competition, following the initial increase in capacity on a route created by entry (including the possible response from the incumbent of adding further capacity). As a consequence, a potential entrant will not experience the anticipated profits from entry and may incur losses which force it to exit. The expectations by operators of tough competition and reactions by incumbents which create a process of costly and unsustainable competition can therefore create a barrier to entry and expansion in an area.

9.38 Motivations for an incumbent operator to engage in competitive behaviours that could be loss-making include:

(a) *Reputation.* An incumbent may engage in aggressive conduct to establish a reputation for being strong and thus discourage further entry. This may apply to an operator with a single network of services, discouraging future entry by fighting against current competitors, or might apply to operators with networks in several areas of the country, discouraging entry in one area by fighting competition in another. In addition, there may be further benefits from preventing a rival establishing itself in an area as it could then expand further from this base. In other words the incumbent, when evaluating the best long-term response, has to factor in the possibility that this will be a repeated event.

(b) *Perception of operator costs.* If an incumbent operator has high costs, it may be vulnerable to profitable entry. Rival operators may perceive the opportunity to emerge victorious from a period of intense competition if greater efficiency means that it will incur relatively fewer costs. Where costs and efficiency are visible, it may be easy for operators to anticipate which one is likely to be best placed to survive a period of competition. If an entrant is uncertain of these costs, a high-cost incumbent may be able to mimic the behaviour of a low-cost operator in order to deter entry. Similarly, in relation to exclusionary conduct once entry has already occurred, a high-cost operator might try to mimic the response of a low-cost operator to try to convince its competitor(s) that entry would not be profitable.

(c) *Imperfect financing.* If one operator has better resources to withstand a period of loss-making competition, it may engage in aggressive conduct to exclude a less well-financed competitor, even if that smaller operator might ultimately be more efficient. This depends on there being an asymmetry in access to finance, such as imperfect capital markets, meaning that even very efficient firms cannot borrow sufficient resources from financial institutions. This might arise if financial institutions lack perfect knowledge of the operators to which they lend and hence might be unwilling to provide all the lending an operator might need. Alternatively larger operators may be able to cross-subsidize loss-making operations from other routes or regions of operation. Small bus operators are likely to face difficulties in obtaining unsecured finance and may face higher costs of finance, and so will be less well placed to tolerate a period of loss-making competition.

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39 Stagecoach pointed out that this overcapacity can also be created by the entry itself rather than by the reaction of the incumbent, especially if the route has been adequately served pre-entry; see Stagecoach response to provisional findings, paragraph 4.12.
For example, Munro’s of Jedburgh told us that the cost of borrowing had recently risen, which affected its ability to secure finance for new vehicles.

9.39 There are many instances of responses to entry which, rather than accommodating entry, instead result in increases to services for an extended period of time (see paragraphs 6.128 to 6.142). We have also found that incumbent operators do not always respond to entry against them. Stagecoach told us that in many cases it did not respond to entry, and it noted where responses did occur, these did not necessarily lead to the exit of either party, but where exit did occur this might be the outcome of effective competition in the market. Operators may also wait for a period to determine the consequences of entry before reacting.

9.40 It can be difficult to assess the nature and impact of responses in individual cases as there may be alternative explanations for service enhancements and fare reductions, such as attempts to grow demand on a particular route. However, we have seen evidence that entrants often expected incumbents to respond to entry and that they perceived incumbents’ reactions as a barrier to entry.

9.41 Some smaller operators told us that specific instances of aggressive competition could create a lasting reputation for retaliation. A Small Operator in Lancaster told us that due to Stagecoach’s scale and capacity to invest, it could not compete with Stagecoach and so did not try to do so, as it expected Stagecoach to respond with extra vehicles. It stated that fear was the main reason that it did not compete directly with Stagecoach and cited the situation with Preston Bus (see paragraph 6.85) as an example of what could happen (see Appendix 6.4—Lancaster, paragraph 18). Another Small Operator told us that the memory of the bus wars between Lancaster City Transport and Stagecoach continued to influence its decision not to try to enter into commercial services (see Appendix 6.4—Lancaster, paragraph 16).

9.42 W H Nelson Coaches (Wickford) Ltd in Essex told us that it did not compete head-on with larger bus operators, as they could simply ‘squash’ its operation. It looked for gaps in the market and sought to take advantage of service withdrawals. Utopia Coaches (Leeds, West Yorkshire) also indicated that entry against large operators was unattractive; it said ‘For a small operator with 8 vehicles, the potential of running head-to-head with larger companies is not viable’. Another operator said, ‘If you owned a small bus and coach business that provided jobs for 30/40 persons, which has limited resources, would you attack the larger operators that run the commercial bus services in your neck of the woods … would you risk it? I won’t.’ In relation to differing ability to survive a period of competition, some Small Operators told us that they would find it difficult to compete with larger operators because of a lack of resources. Olympic Mini-Coaches told us that it would not attempt to compete commercially against a larger operator as it did not have the money to run a commercial service sustainably against a larger operator. Shuttle Buses told us that Stagecoach (against which it competed) had an advantage as a result of its ability to cross-subsidize. Munro’s of Jedburgh, on the other hand, told us that fear of retaliation was not a reason why it did not expand its services, and if it saw a profitable opportunity to expand it would do so. It also noted, however, that it did not think FirstGroup (with which it competed in Hawick, in the Scottish Borders) changed its offering as a result of Munro’s presence. Thames Travel commented that larger

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40 For example, as shown in paragraph 6.133 FirstGroup did not respond to entry in cases out of entry events in the five years to Spring 2010.
41 Stagecoach stated in its response to provisional findings ‘Stagecoach would note that it chose not to respond on 88 occasions of entry against it out of a total of 118 (75 per cent) over a period of five years’, paragraph 3.10 and similarly paragraph 4.18.
42 Stagecoach response to provisional findings, paragraph 3.11.
43 Stagecoach response to provisional findings, paragraph 3.20.
operators tended to react to smaller operators which entered on their routes by trying
to drive them out of business (see paragraph 6.116), and it told us that Large
Operators had ‘deeper pockets’ and so may be able to price so aggressively that a
Small Operator would be forced to exit.

9.43 ALBUM told us that [\textless].

9.44 A number of councils and PTEs told us that incumbent responses formed a barrier to
entry. Fife Council told us that it believed that fear of an aggressive response from
Stagecoach had prevented Small and Large Operators from competing in Fife. It
reported one case of competition by Stagecoach against D Donald in 2003, which
resulted in the withdrawal of D Donald after six months. Similarly, SEStran told us
that attempts by Small Operators to enter into competition with the larger ones had
been met with fierce retaliatory measures, particularly in Fife where Stagecoach had
tended to meet any ‘on the road competition’ head-on until the Small Operator
withdrew, only for Stagecoach to then revert to its original network. SEStran said that
this had involved smaller operators such as Rennies of Dumfertline, Orion Buses and
D Donald, and following these events, there were now relatively few smaller
operators in Fife (Stagecoach had also acquired a variety of smaller operators in
the area).

9.45 Merseytravel said that the perception of exclusionary tactics being exploited served
to distort competition by disincentivizing entry in the market for smaller operators.
Similarly Metro said that fear of aggressive competition was quoted anecdotally as
the reason for not entering the market. [\textless] told us that many Small Operators had
withdrawn from [\textless], either by being acquired by larger operators or as a result of
business failure.

9.46 The Large Operators did not recognize the reaction of incumbent operators as a
barrier to entry. National Express and Arriva both told us that reaction to entry and
expansion by incumbent operators was a feature of competition working well and
Arriva said that a reaction to entry or expansion would be expected in any industry.
Go-Ahead told us that when assessing profitable bus opportunities, entrants would
take into account the expected response of the incumbent operator, but that any
response would be within the parameters of normal competition and this could not be
considered a barrier to entry. Several Large Operators pointed to the examples of
entry and expansion by Small Operators (see Appendix 6.5) as evidence that fear of
or uncertainty over reaction by incumbents was not a barrier to entry for these
operators.\textsuperscript{44}

9.47 However, internal documents of some Large Operators indicated that they took the
possibility of a competitive response into account when considering whether or not to
enter new markets, or in assessing the likelihood of entry against them.\textsuperscript{45} Some of
First [\textless] internal documents note that it had ‘no proposals’ to serve areas where [\textless]
or [\textless] were ‘dominant’ operators and where First [\textless] currently did not have a
presence. Two of these documents note that this was in part because competition
would be severe, eg: ‘There are no proposals to serve these areas, as limited depot
capacity would mean a new base is required to do so and competition would be
severe.’ In [\textless], FirstGroup noted that ‘In respect of [\textless] and [\textless], the strength of First
[\textless] and possible retaliation by us has kept aggressive activity in check’ (see
Appendix 6.4—[\textless]). Similarly, in the Tyneside case study (see Appendix 6.4—
Tyneside, paragraph 35), Arriva said that one of the reasons it did not launch new

\textsuperscript{44} FirstGroup, National Express and Stagecoach.

\textsuperscript{45} This evidence is also relevant to the assessment of strategic retaliation as a response to entry and expansion—see
services in competition with Stagecoach was that when it had competed with Stagecoach or Go-Ahead there were prolonged, hard-fought battles that were very damaging commercially.  

9.48 We asked all operators whether they had ever been put off entering a new area by the reputation of the incumbent firm for retaliation.  

Twenty-five Tier 2 Small Operators said that they had been put off entry by the reputation of an incumbent for retaliation, and 169 said they had not. Out of 16 responses from Tier 1 Small Operators, only one told us that it had been put off entering by an incumbent’s reputation. None of the Mid-Sized or Large Operators told us that they had been put off entering a new area because of the reputation of an incumbent.

9.49 Some of the Large Operators noted these figures represented a low proportion of respondents. We note that the question as drafted focused on the reputation of incumbents in relation to planned entry rather than whether they generally perceived the existence of a barrier to entry. In considering these responses, we note that a distinction may be drawn between, on the one hand, whether a particular incumbent operator has a reputation for taking retaliatory action, and, on the other hand, an assessment by the entrant of the risk that an incumbent will seek to protect its revenue by taking retaliatory action. Many of the operators answering this question seem to have interpreted it in the first, narrower, sense. Some of the operators which said that reputation for retaliation did not put them off entering new areas also said that fear of retaliation inhibited their ability to compete head-to-head with other operators to a large extent. W H Nelson Coaches for example, which did not identify reputation as a factor also said that ‘Given the lack of protection offered by the deregulated environment I have chosen not to take the majority operator on “head on”’. 

9.50 We further note the limited incidence of Small Operators expanding significantly in competition with larger operators. Notable exceptions include Norfolk Green and Western Greyhound, and some other operators that have started from a base with contracted services (eg Veolia and Centrebus).

9.51 There are a number of characteristics of local bus markets which are likely to enhance the potential for reactions to entry to form a barrier to entry or expansion:

- Bus markets are transparent in that other operators’ services and fares are very visible, indeed notice of new service registrations are publicly available before they occur (see Appendix 12.1, paragraph 49).

- It is easy for an incumbent operator to target its response at services directly affected by an entry event through service changes. There can also be route-specific changes to vehicles to enhance quality, and route-specific fare changes and promotions (as for example reported by Album, see paragraph 6.114, Arriva and FirstGroup, see paragraphs 6.118 and 6.119).

- It is possible to compete in ways designed to extract revenue from a rival such as retiming services to run shortly ahead of the rival’s services.

46 See also consideration of some aspects of competition in the Tyneside area set out in Appendix 8.5.

47 These responses may also partly reflect the possibility of strategic retaliation on other routes as well as on the route affected—see paragraphs 9.58–9.65.

48 For the purposes of some of our analysis and data gathering, we have distinguished between two categories of Small Operators. Tier 1 Small Operators are those that are at least the second largest operator in at least one Urban Area with a share of supply of at least 25 per cent, according to our analysis of the Traveline database. All other Small Operators are called Tier 2 Small Operators.
Passengers do not have much brand loyalty and their responsiveness to differences in fares and service quality is limited by other primary considerations; single ticket customers and concessionary fares passengers will prefer the first bus that comes along. If purchasing multi-trip tickets, customers are likely to switch between operators on the basis of service frequency, price and other aspects of service quality and to stay with the current operator only if, for example, it runs more services than its rivals and therefore has a better offer. Consequently there is an incentive to compete on service frequency and timings.

Large Operators can redeploy vehicles and drivers between routes within an area, and may be able to redeploy vehicles between areas. Additional vehicles can also be purchased and rented. Large Operators can also sustain losses during a period of competition through cross-subsidizing activities from other routes and other local markets. Thus, Large Operators may feel confident in engaging in competition with smaller operators if that operator is likely to be resource constrained, but where Large Operators so compete, an extended period of competition may result.

Where an incumbent operator runs a ‘frequent’ service, it can adjust service frequency and timings without having to give any notice or register these changes, which an entrant cannot do unless it also registers a ‘frequent’ service (see paragraph 12.49).

A reputation for aggressive reactions to entry will not just lead to a benefit on the route affected but may deter subsequent entry on the same route and in other areas of operation.

9.52 The Large Operators all told us that a process of normal competition could not be regarded as a barrier to entry.49 In any industry or market entrants will, in evaluating whether entering is likely to be a profitable move, expect that they would have to compete with other suppliers, and naturally entry is less likely to be successful if there is competition with another operator. Large Operators also said that responses to entry were legitimate, pro-competitive actions and any more extreme reactions were limited by the 1998 Act.50 For the reasons set out in paragraph 9.33 we do not consider it unusual to treat the expected competitive responses to entry as a barrier to entry. In the context of the specific characteristics of the bus industry summarized in paragraph 9.51, we consider that the anticipation of responses can and does act as a barrier to entry in bus markets. These characteristics mean that the process of rivalry often tends to focus less on the merits of operators’ offer to customers and more on undermining the profitability of rivals.

9.53 It was also put to us51 that if entry can generate costly periods of post-entry competition, the threat of this will also act as a constraint on the behaviour of incumbent operators. We were told that as entrants were most likely to cherry-pick the most profitable routes for entry, this threat would have a proportionately greater impact on incumbents.52 It was put to us that this forces operators to ensure that they do not leave gaps for entry or seek to exploit any market strength in relation to pricing and service.

50 Responses to provisional findings, Arriva B3-24, B3-29, B3-32, National Express 4–46.
51 For example, Go-Ahead response to provisional findings, paragraph 6.4.6.
52 National Express response to provisional findings, paragraph 4.8, Stagecoach response to provisional findings, paragraphs 3.8 & 3.9.
In our view, this threat is most likely to constrain incumbent operators where they believe that an entrant is likely to be well-resourced or dedicated to entering the route. For example, a small operator is likely to perceive a threat from potential competition if a larger operator is located nearby. However, in cases where an operator perceives itself to be in a reasonably strong position, provided it is able to inflict substantial costs on a rival should entry occur, it is likely to be able to operate with little fear of attracting entry because the rival will anticipate an aggressive response when entry occurs. In such cases, the incentives outlined in paragraph 9.38 will apply and motivate the incumbent to respond even if this involves some initial losses.

**Conclusions on expectations of post-entry competition**

We conclude that potential entrants and potential competitors are aware of the possible reactions of incumbent operators to entry and expansion, and take into account the likelihood of a period of intense competition that will result and the associated sunk costs and risks involved in entry and expansion. In combination with the substantial time that it takes for a new service to reach profitability, the costs arising could be high relative to the scale of entry. Anticipation of this response represents a significant and widespread barrier which will weaken the constraint arising from entry, expansion and potential competition.

The likelihood of a substantial response from an incumbent will depend on the incumbent’s view of how likely it is to survive a period of intense competition. The greater the resources of the incumbent (particularly relative to a prospective entrant), be it locally or more widely, the more likely it is that entry will trigger a strong incumbent response. The incentives to engage in these types of conduct is reduced where routes only partially overlap. We have also identified some exceptions to patterns of intense competition, as outlined in paragraphs 8.66 to 8.81, and so incumbent operators may well not respond to entry in the way described. However, the barrier to entry arises from a potential entrant’s ex ante expectations of what might happen if it does enter. The potential entrant therefore has to evaluate whether there is a risk of a response, and if so whether this risk might impose substantial costs on it.

Another way in which incumbents could respond to entry is through ‘cheap exclusion’, see paragraph 9.36, which we find contributes to the perceived risks and costs of entry as an incumbent operator might utilize such tactics.

**Strategic retaliation in response to new entry or expansion**

In this section, we consider a barrier to entry and expansion arising from an expectation that an incumbent operator might respond through retaliatory actions in competition with the entrant, but elsewhere, ie off of the route on which entry occurred (in contrast to the previous section which considered responses on the route where entry occurred).

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53 Stagecoach pointed out that relative resources of the entrant and incumbent would not necessarily be a reliable guide regarding the reaction of the incumbent. As an example, it quotes its own entry against Preston Bus in 2007, in response to which Preston Bus had purchased new vehicles, increased some frequencies and had retimed services to ‘front run’ in advance of Stagecoach services. However, in the following months Preston Bus’s financial position deteriorated and eventually it was bought by Stagecoach (as described in paragraph 6.85 of our report); see Stagecoach response to provisional findings, paragraph 4.20.

54 Geographic market segregation could provide an alternative reason for absence of entry. Very aggressive competition on other routes as retaliation for entry could also be a punishment for breach of an agreement or understanding (whether explicit or tacit) on segregation.
In paragraphs 8.191 to 8.198, we discussed examples of retaliatory conduct in the context of geographic market segregation. We found several instances within the North-East, the North-West and in Leicester where operators chose to respond to entry through a process of retaliation, but on separate routes. This included examples of establishing entirely new services in competition with the entrants’ services (see for example Appendix 8.5, paragraph 76), and examples of operators responding to entry by enhancing their efforts (through fare cuts or increased services) on other routes where the two operators were already in competition (see for example Appendix 8.6, paragraph 12(b)). Internal papers reviewed in Appendices 8.5 and 8.6 show that these actions were intended as retaliation. As set out in paragraphs 8.184 to 8.198, retaliation tends to be linked with operators defending what they see as their Core Territories, and can be part of a wider process of geographic market segregation.

When an incumbent responds to entry through retaliatory entry on another route, it is undertaking actions that it did not previously consider worthwhile, and therefore are unlikely to be directly profitable. For example retaliatory entry on a route which is already served by an operator will need to be on a significant scale (if customers are to be attracted), and so over-supply is likely to result, meaning that both operators could lose money. This strategy therefore does not seem to us to be profitable in its own right. However, the motivations for this conduct are similar to those in 9.35 and 9.38. It can be expected that this response may lead to two possible beneficial effects. Retaliation by the incumbent on another route will impose costs or reduce the profitability of the entrant’s existing operations. The entrant may, in turn, adjust its service offer or itself retaliate. The entrant might choose to withdraw due to the additional losses it is suffering, in the expectation that the incumbent will withdraw from the routes where it has entered in response.

If in the long run competition between them can be avoided, this might justify the cost of the retaliatory conduct in the short run. Another effect could be to establish a reputation for retaliation. A prospective entrant would take into account the risk that the incumbent might retaliate elsewhere. This would reduce the likelihood of entry or expansion against that operator on other routes in the future, and reduce the extent of competitive pressure from potential competition and new entry.

The examples of retaliation that we have found relate to only a limited number of areas, which we investigated in relation to the issue of geographic market segregation. However, we note that a barrier to entry which reduces the likelihood of entry arises from the ex ante anticipation of possible retaliation, in much the same way as it does from possible on-route responses discussed in paragraphs 8.61 and 8.62. If the motivation for retaliation is to establish a reputation, so as to deter entry in the future, the incentive is for retaliatory conduct to be threatened widely.

Operators are most likely to have an incentive to engage in retaliatory conduct where they face possible entry in many areas. For example if there is multi-market contact with another operator, there is more of an incentive to establish a reputation with them for retaliation. This is most likely to be the case between Large Operators, as they may ‘meet’ a particular rival in several areas. Retaliation can be publicly observed and so this also sends a message to any prospective entrants. Second, because retaliation is likely to impose costs in the short-term, and might itself lead to

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55 Retaliatory responses to entry can be part of wider conduct which has the effect of achieving geographic market segregation. These responses then act as a disciplining measure to impose costs on an operator who encroaches on another operator’s Core Territories.

56 In some cases retaliatory entry might explore profitable opportunities. However, whether or not this retaliation is expected to be profitable, the effect on the entrant is the same where the retaliation happens in response to the entry event; costs or loss of revenue is imposed on the entrant through its other routes, where that would not otherwise have occurred.
further retaliatory responses, an operator will need to be prepared to tolerate short-term losses in pursuit of a longer-term benefit. It is therefore more likely where an operator is well resourced, or particularly wants to protect a certain route. Nonetheless, smaller operators or single area operators may wish to signal that they will not readily surrender market share or accept entry against them, and so could be willing to tolerate the costs of retaliation in some cases.

9.64 The conditions set out in paragraph 9.51 also apply and help explain why this barrier can apply in local bus services.

Conclusion on strategic retaliation

9.65 We therefore conclude that the possibility of retaliation can form a barrier to entry and expansion and help insulate operators from the constraints of potential competition from other operators nearby (whether or not this is part of a wider process of geographic market segregation).

Network and multi-journey ticketing effects

9.66 We now consider possible barriers to entry and expansion arising from network effects and multi-journey ticketing.

9.67 In paragraphs 8.54 and 8.55 we describe the two types of network effects that we have identified in bus markets: within-route and between route network effects. The impact of these network effects on competition is influenced by the type of tickets used by customers.

9.68 Most operators offer tickets for multiple trips (multi-journey tickets), which are usually cheaper per journey than purchasing a series of single tickets to make the same trips. Multi-journey tickets include return tickets and season tickets, which allow unlimited travel for a set period (e.g., day, a week or longer). Season tickets may cover a specific journey or route; where they cover all of an operator’s services in its local network, we refer to these season tickets as network tickets.

9.69 As noted in paragraphs 5.57 and 5.62, there is considerable variability between operators and areas on the proportion of customers purchasing different types of ticket, as well as the proportion of all tickets sold and the proportion of journeys made on operators’ services using different types of ticket. Overall, the figures suggest that, while the majority of tickets purchased are either single or return tickets, season tickets represent a considerable proportion of journeys. As shown in Table 5.8, despite variation across operators, in all cases between 40 and 70 per cent of on- and off-bus commercial revenues is accounted for by multi-journey tickets.

9.70 Given the significance of multi-journey tickets, an incumbent, larger-scale operator may experience an advantage relative to a new entrant or a smaller operator for three reasons.\(^58\)

(a) Size of the network. While all operators can compete on an equal basis for single journeys, a larger operator’s network tickets will be more attractive to a customer

\(^{57}\) In addition, some operators are now developing smart multi-journey ticketing products, for example a ‘pay-as-you-go’ electronic purse for which the price of a trip, or series of trips, may be capped to the best available fare.

\(^{58}\) In addition, we were told that single operator network and period tickets could restrict the ability of other operators to compete for tendered services, such as non-commercial evening and weekend services, if they would then be required to honour return and period tickets offered by another operator who ran part of the service commercially. This could, in turn, increase the incumbent operator’s network strength. This issue is discussed in more detail in paragraphs 13.91–13.96.
who expects to make use of different bus routes to complete varying or inter-
connecting bus journeys. In this case, the operator with the largest network
enjoys a competitive advantage resulting from ‘between route’ network effects.
We discuss this effect further in paragraphs 9.72 to 9.80.

(b) Frequency of service and hours of operation. Customers wishing to make
multiple journeys on a single route are more likely to buy an operator’s return or
season tickets if it offers a more frequent service, or longer hours of operation. If
a customer does not know precisely which bus they may want to use, the
operator with the greater frequency and hours of service provides more options,
and less risk of a long wait than an operator with a more restricted service. In this
case, the operator with the greater frequency and hours of service enjoys a
competitive advantage resulting from ‘within route’ network effects. This may
make services offered by a smaller-scale operator less attractive and so makes
small-scale entry less viable. We discuss this effect further in paragraphs 9.81
to 9.89.

(c) ‘Locking in customers’. Where a customer has purchased a season ticket, they
are likely to be ‘locked in’ to that operator for the duration of the season ticket,59
rather than boarding the first bus that comes along, or selecting a bus on other
aspects of the offer. A new entrant or expanding operator therefore will have little
or no access to customers who hold a season ticket with another operator for the
duration of that season ticket. Within and between-route network effects reinforce
this lock-in effect, and make it likely that the customer will buy a similar season
ticket when the current one expires, unless other operators can make an
attractive offer (such as a comparable network and frequency or lower fares)
which will tempt the customer to change their purchasing behaviour. We discuss
this effect further in paragraphs 9.81 to 9.92.

9.71 Taken together, these three effects mean that an entrant or expanding operator with
a lower frequency of service on a route, restricted services or a smaller network is
disadvantaged in competing for those customers who use an incumbent operator’s
multi-journey tickets. Where these effects are significant, an entrant may need to
come in on a substantial scale to overcome these sources of incumbency advantage.
Entry on a substantial scale increases the sunk costs and risks of entry and creates a
substantial increment to capacity on a route. This can create overcapacity and hence
also increase the likelihood of a vigorous response by the incumbent (see paragraph
8.46. We now consider evidence on each of the three effects set out in paragraph
9.70.

Network size and between-route network effects

9.72 Several operators told us that between-route network effects were unlikely to be of
great significance, as season tickets were used primarily to make return journeys
rather than interconnections across the network.60

9.73 National Express, on the other hand, told us a significant number of passengers
interchanged between services and that the availability of an interconnected bus
network, along with the associated network tickets, is a key reason for people
travelling by bus in the West Midlands. National Express told us that this lead to
benefits to passengers in the form of spillover effects as National Express took action

59 Similarly, a customer who has purchased a return ticket from an operator is more likely to use that ticket for the return trip
than to purchase a single fare from another operator.
60 [><], [><]. Arriva and [><].
across its network to respond to head-to-head competition on a smaller number of routes. Reading Transport told us that survey research into cross-town trips showed that a small but significant number of journeys were identified as requiring more than one bus to complete. Premiere Travel told us that network tickets formed a barrier to entry as operators needed to have a network of services to compete. Shuttle Bus told us that it was difficult to compete over a long period because of the advantage Stagecoach’s multi-journey ticket gave it. It was not feasible for Small Operators like Shuttle Bus to offer their own similar ticket as it did not have the size of network Stagecoach did. GMPTE also told us that passengers in large urban areas were likely to want to travel along a number of routes (see paragraph 5.71).

9.74 To assess the extent of network size and between-route network effects, we reviewed the relevant evidence on customers’ travel patterns.

9.75 The NTS survey found that around two-thirds of season ticket holders make two journeys per day (see paragraph 5.68). Some made further use of networks than this; NTS data indicates that around one-sixth of season ticket holders make more than two journeys per day and our customer survey found that just over half of fare-paying passengers used two or more bus routes on a regular basis (see paragraph 5.65). In paragraph 5.76 we present survey evidence conducted by Stagecoach which is broadly consistent with these findings.

9.76 A substantial proportion of survey respondents used more than one bus to reach their destination. Evidence from the NTS indicated that 10 per cent of all bus journeys involved interconnecting services (18 per cent for season ticket users).61 We also received evidence from a variety of operators62 indicating that on average, in some areas, tickets were used substantially more than twice a day. However, it was not clear whether this was because individuals were using them to make different journeys or making repeated trips on the same route. Evidence from parties indicated that the number of journeys per ticket varied substantially between areas, the highest rate of use being reported by National Express West Midlands.

9.77 In addition, between-route network effects can also arise where customers use different routes for different types of journey (for example, commuting and leisure trips). According to the NTS, 44 per cent of bus users used the bus for more than one journey purpose in a week and 11 per cent of bus users used the bus for more than one journey purpose in a day (see paragraph 5.70).

9.78 Taken together, we concluded from this evidence that network size and between-route network effects can be significant though the extent of such effects varied between locations.

9.79 Go-Ahead told us that network tickets could increase the amount of journeys taken on routes in the network, without this having been a factor in the decision to purchase a single-operator multi-journey ticket, as it believed the purchase of a multi-journey ticket is driven by the ability to make a repeat return journey. We have seen no evidence to support Go-Ahead’s argument. In addition, we note that the ability to make repeat return journeys itself gives rise to within-route network effects discussed in paragraph 9.70(b).

61 See paragraph 5.75.
62 For example, FirstGroup provided figures on the number of journeys made on average for its daily, monthly and weekly tickets for its [x] and [x] operating companies. The day ticket was used on average [x] times in each of the three operating companies respectively. The average number of journeys per weekly ticket is [x] and [x] in each of the operating companies respectively, which suggests that a proportion of customers are using the ticket to make multiple journeys.
9.80 We concluded that for some customers, the ability to buy a discounted ticket that allows travel on a network of routes is likely to be attractive. The extent to which this represents a source of incumbency advantage for larger network operators will vary between different areas. We do not have systematic data on use of network tickets or use of multiple routes to allow us to assess precisely where network strength is most important. It seems likely, however, that these effects will be most substantial in larger conurbations, or in other Urban Areas in which there are multiple centres for employment, entertainment, shopping etc. In such areas, passengers are more likely to want to make a variety of journeys compared with smaller centres of population where most of these facilities are located nearby.

Frequency of service, hours of operation and within-route network effects

9.81 Some operators told us that within-route network effects were unlikely to be of great significance, as customers did not have a particularly strong preference for operators running frequent services.

9.82 For example, Arriva told us that many customers who used buses had time-specific journeys, often travelling at peak times in order to get to and from work, school or college at the start and end of the day. Similarly, Go-Ahead told us that some customers travelling at peak times would not value frequency, if they planned to arrive for a specific bus. Having journeys available to them at other times when they were not required was of no benefit to these travellers.

9.83 However, we noted that in order to compete effectively at peak times, an operator would have to provide a high-frequency service at these peak hours. ALBUM told us that a new entrant would need to run its services at a reasonably high frequency relative to the incumbent in order to compete (ALBUM estimated that at least 50 per cent of the incumbent’s frequency would be necessary).

9.84 We expect that customers purchasing a multi-journey ticket would generally prefer an operator with more frequent services, as this provides more options and reduced waiting time. This is supported by the evidence set out in paragraphs 5.48 to 5.51. As shown in Table 5.5, just over one-third of passengers told us in our survey that, where they had a choice of operators, they would switch between operators (at the planning stage of a trip) if the operator halved the frequency of the service.

9.85 In line with this survey evidence, many operators told us that service frequency was a very important issue for customers and ranked only behind reliability/punctuality (see paragraph 5.29). We also heard from operators that running sufficiently frequent services was an important element of maintaining service quality and deterring entry. While we do not have survey evidence relating to the hours of operation, we note that in a couple of cases operators told us that their total bus usage was influenced by their decisions to run early morning or late evening services.

9.86 We acknowledge that, as indicated by Arriva and Go-Ahead in paragraph 9.82, some customers plan to catch a specific bus. This is likely to be the case for services that run very infrequently where waiting times at the bus stop could be long. However, in relation to planned journeys, our customer survey showed that customers would tend

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63 Contrary to this, Arriva said that 'if competition comes in, it does not have to compete head-to-head along the whole route the whole time, it can come in and compete at peaks and do quite serious damage to the business, just coming in and cherry-picking, almost, passengers. So very high frequency at peak times but then perhaps not in the off-peak parts of the day'. Stagecoach also provided one example of an operator in Manchester that competed only at peak times on a certain route.

64 For example, see Stagecoach’s hours of operation in the Oxford case study, Appendix 6.4, paragraph 36(c).
to switch between operators at the planning stage of their trip in response to relative changes in frequency, among other factors (see paragraph 5.47).

9.87 To investigate the significance of within-route network effects, in Appendix 9.1 we present an analysis of: (i) the proportion of passengers travelling on a route that purchase multi-journey tickets for use on that route; and (ii) the existing frequency of service on a route. These factors indicate the likely strength of within-route network effects as a barrier to entry:

(a) The proportion of revenue accounted for by multi-journey tickets purchased for use on each route indicates the proportion of revenue that is unlikely to be contestable for a new entrant or expanding operator with a significantly lower frequency than that of the incumbent. The greater the proportion of multi-journey ticket revenue, the more likely the entrant or expanding operator is to need to offer a frequency of service similar to that of the incumbent in order to compete for this revenue, and hence the greater the barrier to entry or expansion on that route.

(b) Where an incumbent offers a high-frequency service, within-route effects will imply, all else equal, that the scale of entry or expansion will need to be greater for the entrant to be able to compete for multi-journey ticket holders. As a result, on these services a smaller-scale incremental entry or expansion strategy is less likely to be viable. This implies that on higher-frequency services, within-route effects are likely to create a greater barrier to entry and expansion. Therefore the existing frequency of service on a route is an important indicator of the strength of the barrier to entry or expansion on that route.

9.88 In Appendix 9.1 we analysed these two factors at both the route- and Urban Area-level. We found that within-route effects were likely to be present on almost all routes at least to some degree, but were strongest on those routes with both a relatively high proportion of revenue accounted for by single-operator multi-journey tickets and a relatively high frequency of service. We also found that larger Urban Areas tended to have more routes characterized by relatively strong within-route effects.

9.89 Taking all the evidence in paragraphs 9.84 to 9.88 together, we concluded that within-route network effects represented a significant and widespread barrier to entry and/or expansion.

Locking in

9.90 In relation to the third effect, it was put to us that customers are only ‘locked in’ to the incumbent operator for the duration of the ticket. For example, Arriva, Stagecoach and Go-Ahead told us that a day or week was a typical season ticket period, and that as a result operators were only able to ‘buy loyalty’ for this relatively short period of time. Arriva told us that in its view this should not be regarded as a form of foreclosure of other operators, as the periods involved were so short and take-up of these ticket types were low.

9.91 However, season tickets are generally cheaper per journey than purchasing singles or returns, and so regular travellers are likely to want to continue purchasing such tickets. Therefore, for as long as an incumbent operator has some form of network

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65 Go-Ahead also told us that it had a refund policy on its annual tickets whereby it would refund proportionate to the time remaining on the ticket, if customers wished, and so customers on these tickets were not ‘locked in’.
66 See paragraph 5.54.
advantage it is likely that passengers will renew their season tickets. Any operator can offer season tickets, but the value customers attach to this—and hence their willingness to pay—will depend on service frequency, punctuality, hours of service and/or network of routes.

9.92 We therefore concluded that the lock-in effect increases the impact of within- and between-route network effects on barriers to entry and/or expansion. The extent of lock-in effects will vary locally according to the types of tickets purchased by customers.

Evidence on operators’ perceptions of network and ticketing effects

9.93 Operators had different perceptions of the extent to which network and ticketing effects represented a barrier to entry or expansion. These perceptions varied according to a number of factors, including the size of the operator and their location.

9.94 In the West Midlands, we found extensive evidence that the high take-up by customers of the National Express Travelcard was perceived by operators (of all sizes) as a very significant barrier to entry into Birmingham bus markets. This was reflected in complaints we received from small operators. Midland Choice stated that National Express’s Travelcard stopped other operators from expanding their business because 50 to 60 per cent of passengers were already tied up with these products. It stated that this appeared to be the reason why Go-Ahead’s entry into the Birmingham market had been unsuccessful despite having the resources and experience of a PLC. Rotala also highlighted the strong position of the National Express season ticket due to its long-standing position in the West Midlands. In the West Midlands, some operators (such as) have at times offered cheap single tickets (eg 50p) to passengers holding a National Express Travelcard even though the operator will receive no reimbursement for this reduction. This was done in an attempt to persuade National Express Travelcard holders to use their services.

9.95 Similar concerns were expressed in other parts of the country. For example, Abus told us that it was difficult to compete with FirstGroup’s multi-journey tickets in Bristol and that passengers who had bought a weekly ticket would tend not to use Abus’s services. For this reason Abus had decided to allow FirstGroup day and weekly ticket holders to travel on its services for 50p.

9.96 Huyton Travel told us that it had entered a commercial service on a high frequency corridor in Liverpool, which was served by both Stagecoach and Arriva. Due to the high frequency of services offered by Arriva and Stagecoach, Huyton Travel told us that it had found it virtually impossible to compete as it could only offer a frequency of 20 to 25 minutes. Huyton Travel also told us that both of these operators were also selling weekly tickets, so passengers were locked in to travelling with one of them. Huyton Travel had tried to compete on a single ticket basis, and initially had tried to undercut the main operators’ prices, but this strategy had not proved successful, and it had withdrawn its service after about 18 months.

9.97 [told us that: ‘Operator’s network tickets also create an impediment to competition. They create a situation where passengers will not board a competitor’s bus but will wait for a bus where they can use this ticket. Clearly small operators are unlikely to have a large network of services that make this type of ticketing possible.’ W H Nelson Coaches said that:

67 See Appendix 6.4, paragraphs 45–50.
68 National Express told us that Centro had introduced a direct debit version of the multi-operator ticket.
As a company we have experienced difficulties in competing with the incumbent operator where we are offering lower frequency bus services. We have also noted reluctance on the part of the customer to try new services as they can be conservative by nature. It is difficult to compete where the competition can offer a whole network or regional ticket that ties users into their own services.

9.98 Bluebird Bus told us that Large Operators’ fares were structured in a way that made their single fares particularly expensive and encouraged people to buy their day tickets. However, Bluebird Bus found that the multi-operator ticketing scheme in Manchester allowed passengers to use other operators.

9.99 The extent to which network effects and network tickets are perceived as important by smaller operators seems to vary between operators and across areas, with many smaller operators being unconcerned about network tickets. In the responses to our questionnaires, 60 per cent of Tier 2 Small Operators told us that other operators’ network tickets did not impact on their ability to compete, and many operators did not highlight this as an area of concern. We noted that these would include some operators whose services do not overlap with a substantial network operator or who are not trying to compete head-to-head with such operators.

9.100 Some operators told us that concessionary passengers provided a source of business where network tickets did not act as a barrier to entry, although only around 36 per cent of journeys are made by concessionary passengers (see paragraph 2.8) and these carry a reduced rate of reimbursement compared with full-fare passengers. For example, W H Nelson Coaches said that:

Interestingly one of the unexpected effects of the concessionary fares schemes has been that those users travel freely around the whole bus network irrespective of the operator. Not having to buy a return ticket (and therefore be tied to one company’s services) means that those passengers are far more likely to roam around the whole network and take advantage of ad-hoc connections unavailable to paying users.

9.101 Some evidence from the Large Operators’ internal papers suggest that they regard networks and associated tickets as a source of competitive advantage. For example, ‘the market advantage we possess is that none of them [the other operators] cover the same network as ourselves or offer such a range of tickets.’ [X] noted that one of its strengths was its ticketing, as more than more than 50 per cent were loyalty tickets. When considering the risk that customers might switch to a cheaper [X] noted that a mitigating factor to this risk was that [X] success was ‘dependent on increasing their network’ and that the likelihood of this risk was low. [X] had a competitive advantage as a result of its network of services and associated tickets: [X].

9.102 Stagecoach told us that it was not in its experience generally necessary for an expanding operator to have a network of services in order to be able to compete with an incumbent’s season tickets, and the importance of this in each area depended on the proportion of customers using the network. Stagecoach told us that in several towns where it operated only a limited number of services compared with a larger incumbent’s network, it was able to compete by offering substantially lower-priced route-specific season tickets. It cited examples of this in Cardiff, Coventry, Aberdeen, Liverpool and Sheffield. Stagecoach told us that if passengers use a second ‘regular’ route once a week only, it might be cost effective to purchase a route specific season
ticket from one operator, and a day network ticket on that day when the passenger wishes to use an extra route. While we recognize that the strength of network effects as a barrier to expansion will depend on the proportion of customers using a network of routes in each Urban Area, the fact that Stagecoach’s route-specific tickets are substantially cheaper suggests in itself that these products are less attractive than an incumbent operator’s network tickets.

9.103 Stagecoach, FirstGroup, Go-Ahead and Arriva all noted that the price of a single ticket was anchored to the price of a season ticket, so if operators competed with small entrants for single-ticket customers, this would also constrain the pricing of season tickets. We recognize that in order to make season tickets attractive, there has to be a relationship to the pricing of single tickets. However, the overall competitive constraint will be dampened if a proportion of passengers will not switch to rival operators because of the network and pricing advantage of season tickets. FirstGroup also told us that single tickets would become more attractive if there was new entry by a smaller operator as they offered increased flexibility to travel on any operator’s services. FirstGroup told us that this would put pressure on an incumbent to decrease the price of its network ticket. However, multi-journey tickets still offer a discount compared with single tickets (see paragraph 5.47), and so any value from flexibility would need to be significant enough to overcome this.

Conclusions on network and ticketing effects

9.104 We find from this evidence that network effects and network tickets are perceived to be a source of incumbency advantage by some large and some small operators. The extent to which these effects are perceived as important varies between operators and across areas. Based on the evidence set out in paragraphs 9.66 to 9.103, we concluded that network and ticketing effects constitute a significant barrier to entry. In particular:

(a) between-route network effects represent a significant barrier to entry and/or expansion, particularly in larger and/or more complex bus networks (see paragraphs 9.72 to 9.80);

(b) within-route network effects represent a significant barrier to entry and/or expansion that is likely to be present to some degree on most routes (see paragraphs 9.81 to 9.89); and

(c) lock-in effects increase the impact of within- and between-route network effects on barriers to entry and/or expansion. The extent of lock-in effects will vary locally according to the types of ticket purchased by customers (see paragraphs 9.90 to 9.92).

9.105 Offering a more frequent service, a network of services, and attractive ticketing options are all ways in which operators compete and seek to improve their offer to customers relative to rivals, and from which customers benefit. Nonetheless, where an incumbent offers a well-established frequent service—or a network of such services, without obvious gaps—and where their season and network tickets carry a pricing incentive relative to single tickets, it will be more difficult for an entrant to attract customers. This implies that an entrant will either have to enter on a larger scale, or accept a reduced ability to attract customers. Entry on a large scale involves increased costs and risks, and may create overcapacity on the routes where it enters (see paragraph 9.16).
Multi-operator tickets

9.106 In this section and in Appendix 9.2, we review the evidence on existing multi-operator ticketing schemes. Such schemes might be one way in which new or expanding operators may be able to overcome barriers to entry or expansion associated with network and multi-journey ticketing effects (see Appendix 15.1). Some smaller operators told us that the absence of multi-operator tickets could impact on their ability to compete against an operator with a large network and higher frequencies (see for example paragraph 6.116).

9.107 First, we consider the extent of Urban-Area⁷⁰ level travelcard schemes that small operators can join (see paragraphs 9.108 to 9.113). Second, we consider the effectiveness of those schemes (see paragraphs 9.114 to 9.127).

Extent of Urban-Area-level ticketing schemes

9.108 As set out in paragraphs 3 to 6 of Appendix 9.2, we found that multi-operator tickets covering individual towns or urban networks were relatively rare. The majority of Urban Areas have no multi-operator travelcard scheme. Even among the 60 largest Urban Areas, only 35 per cent have an Urban Area-level multi-operator travelcard scheme and 33 per cent have no travelcard scheme at all (ie not even one covering a wider geographic area).

9.109 A number of factors were identified by parties as being potential obstacles to setting up new multi-operator ticketing schemes.

9.110 Several Large Operators told us that multi-operator travelcard schemes did not exist in certain areas because there was no demand for these products. They did not, however, provide any further research into the demand for multi-operator travelcard schemes to support their argument. As set out in paragraphs 9.80 and 9.88, our analysis suggests that while network effects are likely to be present in larger or more complex bus networks, within-route effects are likely to be present on almost all routes, at least to some degree. Take-up of multi-journey tickets is high (see paragraphs 5.53 to 5.62), indicating that there is likely to be passenger demand for multi-operator tickets if sold at a reasonable price on attractive terms. In addition, in paragraph 8 of Appendix 9.2 we present survey evidence from Passenger Focus which shows that there is unsatisfied customer demand for multi-operator tickets in England outside London.

9.111 Stagecoach told us that operators tended to rely on local authorities to promote multi-operator schemes, in part because of the possibility of accusations that an operator-led scheme would be anti-competitive and in breach of competition law. Other operators complained about a lack of enthusiasm or cooperation on the part of the LTA and/or larger incumbent operators to take part in multi-operator ticketing schemes or other initiatives. We were also told about some practical difficulties in establishing multi-operator ticketing initiatives, for example in establishing a fair system for reimbursement and technical and operational issues in accepting another operator’s tickets.

9.112 We also asked LTAs in certain larger Urban Areas⁷¹ why in their view there was no multi-operator ticketing scheme specific to that Urban Area. The most common

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⁷⁰ See paragraphs 4.11–4.33 for a description of how we have defined Urban Areas for the purposes of our analysis.

⁷¹ We asked all LTAs responsible for Urban Areas with a population greater than 150,000 without a multi-operator ticketing scheme specific to that Urban Area.
reason cited by these LTAs was difficulty in getting the operators to participate or agree appropriate terms. Large Operators also provided their views on why attempts to pursue a multi-operator ticketing scheme in particular areas had been unsuccessful. This evidence is presented in more detail in paragraphs 9 to 14 of Appendix 9.2.

9.113 We found that there are many Urban Areas without Urban-Area-level travelcard schemes. This, self-evidently, limits the extent to which small or expanding operators in these areas are able to participate in such schemes to overcome barriers to entry or expansion associated with such schemes. The reasons why schemes do not exist in particular areas reflect a variety of local factors, including the views of local operators and/or the LTA. However, for the reasons set out in paragraph 9.110, we disagreed with certain Large Operators that an absence of customer demand for an effective local multi-operator ticketing scheme was an important reason for the small number of Urban-Area-level schemes that we have observed.

Characteristics that limit effectiveness of existing schemes

9.114 As set out in paragraphs 16 to 23 of Appendix 9.2, we found that where multi-operator schemes do exist, uptake of the tickets available under these schemes is generally low, although there is significant variation between schemes.

9.115 To understand the reasons for the low level of take up, we reviewed the main characteristics of existing travel card schemes (see paragraphs 24 to 34 of Appendix 9.2). This analysis shows that the effectiveness of each existing multi-operator travelcard is limited by at least one of the following characteristics:

(a) the sales channels through which tickets are available—multi-operator tickets are often not available through the same sales channels as single operator tickets. For example, in certain schemes, customers are not able to buy multi-operator tickets on the bus;

(b) the ticket types that are available—multi-operator tickets are often not available over the same time period as single operator tickets (for example day, weekly and monthly tickets) or concessions are not available to particular groups (for example students);

(c) the existence of a bus-only multi-operator ticketing scheme—some ticketing schemes only offer a multi-modal version, which may not be attractive to customers who only wish to travel by bus; and

(d) the zonal coverage of tickets—some ticketing schemes only cover wide geographic areas. This is likely to limit the take-up of these schemes by customers wishing to travel only within a narrower area.

9.116 A further important reason for the limited customer uptake of multi-operator tickets is because such tickets are more expensive than operator-specific multi-journey tickets available in the same areas. In Tables 5 to 14 of Appendix 9.2, we set out a comparison of prices between operator-specific and multi-operator tickets. This analysis shows that multi-operator tickets are always priced higher than single-operator tickets, although the price premium varies considerably across local areas and across ticket types. In a situation where one operator already provides the bulk of services, there may be little incentive for a customer to purchase a multi-operator network ticket at a higher price.
A multi-operator ticket might be expected to be sold at a price premium over an equivalent operator-specific ticket for two reasons. First, where a customer values the ability to travel on several different operators’ services (either along one route or on different routes in a network), multi-operator tickets may offer greater utility than operator-specific tickets. As a consequence, individual operators are likely to need to offer their own multi-journey products at a discount to the multi-operator ticket, in order to attract customers. Second, if an operator loses the sale of one of its own network tickets as a result of a customer choosing a multi-operator ticket, its revenues may be reduced as it might receive only some proportion of the ticket value back (depending on the reimbursement mechanism used and the customer’s use of the ticket). As a result of these two effects, operators will have incentives to offer a discount on their own tickets to get consumers to purchase them over the multi-operator ticket. For example, Cardiff Bus told us that the south-east Wales multi-operator ticket was priced at a premium compared with the single-operator day tickets, so as not to undermine the sales of these single-operator day tickets. We noted, however, that this price premium reduces use of such tickets and so limits the ability of multi-operator ticketing as a factor offsetting network and ticketing advantages as a barrier to entry.

In addition, we have found that decisions relating to multi-operator ticketing schemes (including their price) are usually determined by the votes of a group of incumbent local bus operators (see paragraphs 26 to 30 of Appendix 9.2 and paragraphs 2 to 4 of Appendix 15.2). Where no agreement is reached, the ticket characteristics remain the same and prices often rise in line with inflation. Incumbent operators will often have an incentive to seek to increase the price of multi-operator tickets, since this will make offering a discount on their own tickets (compared with the price of multi-operator tickets) less costly. Incumbent operators may also have incentives to prevent the development of multi-operator tickets that are close substitutes for their own multi-journey tickets. These incentives, particularly in relation to the largest operators in the area, may be reinforced by the potential for multi-operator tickets to reduce barriers to entry or expansion associated with operator-specific season tickets and network effects.

We saw, for example, some evidence from internal documents from FirstGroup (see paragraphs 35 to 38 of Appendix 9.2) that it had sought to increase prices of multi-operator tickets in Manchester in order to achieve some ‘headroom’ and ‘breathing space’ above the price of its own tickets. FirstGroup told us that this referred to a time when the mechanism for deciding prices failed properly to take account of operators’ costs, and increases in multi-operator ticket prices were required to take account of these costs.

We have also had some concerns raised by Small Operators and LTAs about the operation of particular multi-operator ticketing schemes. These relate to the pricing of multi-operator tickets, to the nature of the ticketing products available under the schemes and in some cases to the conditions on which smaller operators could access the schemes.

Rotalla and a number of Small Operators in the West Midlands told us that the price of the West Midlands multi-operator ticket limited its take-up. In addition, we note that the multi-operator ticket is only available over a wide geographic area, whereas National Express’s operator-specific ticket is available over smaller geographic regions, and (weekly or longer duration) tickets for smaller geographic regions are

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72 The exception to this is the multi-operator ticket in Merseyside, the price of which is set by Merseytravel.
73 [x], Midland Choice, Central Buses and The Green Bus.
available at considerably lower prices. As set out in Appendix 9.2, paragraph 26, National Express effectively has a veto over changes to the scheme including changes to fares\(^{74}\) and changes to the geographic coverage of the multi-operator ticket.\(^{75}\) Rotala and several Small Operators complained about National Express’s veto and the corresponding difficulties in developing the multi-operator ticket (in particular introducing smaller zones) and achieving reductions in the price of the multi-operator ticket in the West Midlands. We note that multi-operator ticket prices in the West Midlands are low compared with those of a some PTE schemes, though they are higher than others. Greater detail on the West Midlands multi-operator travelcard scheme is presented in Appendix 9.2 and in Annex A to Appendix 15.1.

9.122 Concerns were also raised by B&NES Council in relation to the voting mechanism by which prices were set for the Bath multi-operator scheme. B&NES Council told us that a simple majority was needed to change fares, and as the largest operator, FirstGroup was allocated two out of the four votes. As such, FirstGroup effectively had a veto over changes in the price of the multi-operator ticket. FirstGroup told us that all decisions to date over prices of the Bath multi-operator ticket had been made unanimously by all operators (see Appendix 9.2, paragraph 30). B&NES Council also told us that a price could not be agreed for student multi-operator ticket prices, as FirstGroup argued that students should be priced as adults. This was despite FirstGroup offering a student discount on its operator-specific tickets. Student multi-operator tickets are not therefore offered in Bath. FirstGroup told us that it and other local operators had argued that students should be priced as adults for simplicity and because there were other discounted options available to students including Wessex (Rotala) and FirstGroup’s respective carnets.

9.123 We have not received any other concerns that an individual operator has a controlling position in any other voting mechanism that determines changes to multi-operator ticket prices or the products on offer.\(^{76}\) However, GMPTTE and Metro also told us that incumbent operators were collectively able to control prices such that multi-operator tickets would always be unattractive in comparison with operator-specific tickets. FirstGroup told us that the Large Operators in West Yorkshire did not collectively have a controlling position. As set out in paragraph 9.117, at least some price premium between multi-operator and operator-specific tickets is probably to be expected. Operators will have an interest in using their votes with the aim of bringing this about through an increase in the multi-operator ticket price, rather than by reducing the price of their own multi-journey tickets. Where the largest incumbent operator has a controlling position in the voting mechanism, this is likely to increase the ability to act on these incentives. In two of the three areas where we have seen this exists in practice (Bath and the West Midlands), the incumbent operator appears to have also been able to veto changes to the coverage of the tickets, which in our judgement would have made the tickets more attractive to consumers.

9.124 We also received a few complaints from Small Operators about their ability to access multi-operator schemes and the terms on which they were able to participate in such schemes, including, for example, the way in which revenues for the scheme were allocated between operators (see Appendix 9.2, paragraphs 41 to 55).

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\(^{74}\) As noted in Appendix 9.2, paragraph 26, when a fare change is not agreed, fares rise in line with the consumer price index.

\(^{75}\) National Express highlighted concerns with altering the geographic coverage of tickets, due to the implications this might have on the accuracy of reported boardings used to allocate revenue from the multi-operator ticket between participating operators (see the discussion at Annex A of Appendix 15.2).

\(^{76}\) The voting scheme for the Kangaroo scheme in Nottingham (as outlined at paragraph 50 of Appendix 6.4—Nottingham) might give rise to a situation where an individual operator had the ability to veto changes, but we have not received complaints about this scheme similar to those received for the West Midlands or Bath.
Conclusion on existing multi-operator ticketing schemes

9.125 Our analysis of existing multi-operator ticketing schemes leads us to conclude that the current pro-competitive impact of multi-operator ticketing schemes is limited for the following reasons:

(a) First, there are relatively few multi-operator tickets covering individual towns or urban bus networks: only 35 per cent of the largest Urban Areas have their own Urban Area-level scheme.

(b) Second, where schemes do exist, they have one or more characteristic that limits their attractiveness to customers.

(c) Third, existing schemes are priced at a significant premium above operator-specific tickets. This third factor appears to be largely as a result of the incentives on operators to introduce a price premium between multi-operator and operator-specific tickets. This premium might be achieved in part through the voting mechanisms that determine multi-operator ticket prices and the nature of the multi-operator products available. We also note that individual operators are able unilaterally to introduce a premium by discounting their own season ticket.

9.126 We also received some complaints about the terms on which Small Operators were able to access multi-operator schemes, though these concerns did not appear to be widespread.

9.127 We concluded that multi-operator ticketing schemes, as currently operated, are insufficient to enable new or expanding firms to overcome barriers to entry and expansion associated with large incumbent operators’ network strength.

Charges and access to bus stations

9.128 In some towns, local geography and custom mean that bus stations are key points for passengers using bus services and hence access to them is important for successfully running local bus services. If a new entrant or expanding operator is disadvantaged in accessing bus stations, then this may create a barrier to entry or expansion, where these bus stations are important facilities for operators and passengers.

9.129 Bus stations are owned by either:

(a) local authorities;

(b) private companies that are not local bus operators (eg shopping centres and airport operators); or

(c) local bus operators.

9.130 Most bus stations used by the Large Operators are owned and operated by local authorities. The owner of a bus station is, however, not necessarily its manager/operator. Where private companies other than local bus operators own bus stations, operation of the bus station is usually outsourced to a local bus operator. Operation of a bus station involves setting third-party departure charges, as well as, in most cases, managing bus stand allocations. Bus station operations that are not outsourced are mainly at airports and railway stations. We have received some suggestions that bus station operators which did not provide bus services themselves might discriminate among their customers, although in our view this seemed
generally unlikely to arise as in most cases such operators would have no obvious incentive to do so.\textsuperscript{77}

9.131 The 1985 Act sets out certain requirements on PTEs and local authorities\textsuperscript{78} in relation to the provision or operation by them of bus stations and any associated facilities, including specifically charges for their use. Section 82(1) of the 1985 Act prohibits PTEs and local authorities from discriminating, directly or indirectly, against any holder or class of holder of a PSV operator’s licence when exercising their powers in relation to the operation of bus stations. This prohibition also applies to any person to whom a PTE has contracted out the operation of a bus station provided by it under its contracting-out powers (section 82(3)). We received no substantiated evidence that the ownership of the bus station by the local authority may be acting as a barrier to entry or that the provisions of the 1985 Act were being breached.\textsuperscript{79}

9.132 Difficulties in gaining access to bus stations can also arise because there is no spare capacity at a bus station. While capacity might be created by limiting stand time or arranging for buses to layover elsewhere, Large Operators told us that limited bus station capacity was a problem (or a likely future problem) at 26 bus stations in the reference area. In the event of large scale entry, some constraints on capacity may be inevitable, as it is doubtful that all bus stations would be designed with sufficient spare capacity to be able to cope with a sudden and significant increase in the number of services operating. However, other constraints on bus station capacity and new entry are potentially avoidable, and our assessment has concentrated on how existing bus stations are managed and operated.

9.133 We consider two issues relating to bus stations:

(a) First, we consider whether new entrants or expanding operators experience difficulties gaining access to bus stations (see paragraphs 9.135 to 9.146).

(b) Second, we look at whether new and/or expanding operators face higher charges for use of the bus station in comparison with incumbent operators (see paragraphs 9.147 to 9.157).

9.134 In light of our findings at paragraphs 9.129 to 9.131, we have explored these issues with particular attention to cases where an existing bus operator manages a privately-owned bus station.

Access to bus stations

9.135 We asked LTAs about the ownership of bus stations in their local area and whether they had any concerns in relation to access to these bus stations. Eighty-nine LTAs provided us with information on the bus stations in their local area. Most LTAs told us

\textsuperscript{77} One possible exception could arise where a rail operator manages a bus station or bus stops on the station and is part of a larger transport group which includes bus interests, or where it may see local bus services as a potential competitor with some train routes. Another exception would arise where the private owner of the bus station has significant market power in its market, Stagecoach told us that there have been two recent court cases seeking interim orders regarding allegations that BAA has abused a dominant position by allocating bus stands at its airports in a discriminatory manner (see Stagecoach response to provisional findings, paragraph 4.33).

\textsuperscript{78} For these purposes, the term local authorities includes, in relation to England and Wales, the council of a county, London borough or district of the Common Council of the City of London; and in relation to Scotland a council (see section 83(4) of the 1985 Act).

\textsuperscript{79} We also sought views on departure charges at all bus stations managed by a local authority which also owned a local bus operator and received no evidence of varying charges being applied to different bus operators. However, issues in relation to allocation of bus stands are described in the Cardiff case study (Appendix 6.4—Cardiff, paragraph 36): we found that capacity issues were mitigated by the availability of stands outside of the station.
either that there was no bus station or that the local bus stations were owned by the local authority and/or that access was not considered an issue.

9.136 Fourteen LTAs told us that they had some concerns in relation to the bus stations in their local area. The details of their concerns are set out in Appendix 9.3.

9.137 Three LTAs were concerned about issues relating to the current capacity of the bus station or future capacity of the bus station following potential redevelopment. A further three LTAs had minor concerns relating to the day-to-day management of bus stations owned by local bus operators, including the allocation of departure bays, their ability to display departure information, or driver access to facilities (eg canteens and toilets).

9.138 Four LTAs expressed general concerns about access and charges at privately-owned bus stations. Four other LTAs raised more detailed concerns in relation to bus station access and departure charges. Additional concerns raised by Medway Council and Nexus are also set out in Appendix 9.3.

9.139 For those bus stations that were privately owned (ie either by a local bus operator or a private company) and managed by a local bus operator, we asked the local bus operator-manager at each bus station whether they had denied any requests for stand allocations since 2008. All these operators (Arriva, FirstGroup, Stagecoach, Go-Ahead and Ensign Bus) told us that they were unaware of any instances where stand allocations had been denied.

9.140 We asked Small Operators whether access to bus stations/stands limited their ability to compete. Of the 185 responses we received from Small Operators: 10 per cent (19 operators) told us that access to bus stations/stands limited their ability to compete to a large extent; 18 per cent (33 operators) told us that it limited their ability to some extent; and the remaining 72 per cent (133 operators) stated that it did not impact on their ability to compete at all.

9.141 Rotala and Veolia submitted evidence relating to Worcester bus station. This is detailed in the Worcester case study (see Appendix 6.4—Worcester, paragraphs 34 to 64). This case study illustrates the restrictions of competition that can arise where a local bus station is privately owned and is operated by the incumbent bus operator in an area. We found that under such circumstances:

(a) the local bus operator is made aware of the intentions of a potential entrant in advance of the entrant’s registration of services, thus gaining a competitive advantage;

(b) the incentives of the operator of the bus station to manage capacity efficiently are dulled; and

(c) the local authority’s ability to intervene to facilitate entry is constrained.

9.142 In particular, in Worcester, FirstGroup objected to Rotala’s registration of a new service on the basis that there was no spare capacity at the bus station. However, on balance, the evidence we have seen suggests that there was some spare capacity at the bus station to accommodate the new service, albeit possibly at a lower level of frequency than Rotala had intended. An independent consultant also concluded that

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80 In certain cases, the local bus operator held the bus station on lease agreements.
81 However, these responses did not indicate whether problems of access related to a lack of available capacity or the conduct of the operators of bus stations.
the adoption of better management practices could deliver increased capacity at the bus station (see Appendix 6.4—Worcester, paragraphs 92 to 97).

9.143 Bournemouth Transport\(^{82}\) told us that Poole bus station was owned by its main competitor, Wilts & Dorset (a subsidiary of Go-Ahead), and that Wilts & Dorset derived a competitive advantage from its control over stands and departure charges. Bournemouth Transport told us its services that competed against Wilts & Dorset were not allocated to convenient stands, and it considered access to the bus station as a major challenge to its ability to compete and develop its operation over the next three years. The Borough of Poole also noted these issues, although it said that since the acquisition of Wilts & Dorset by Go-Ahead, other operators were allowed stand space at Poole bus station, and an adjacent car park provided some substitute facilities even if this was less attractive to operators.

9.144 Transdev added that Bournemouth Transport had received notifications of tenders in the Salisbury area on a number of occasions, and it had considered developing its business in that area (around 25 miles from its existing depot). However, the bus station in Salisbury is operated by Wilts & Dorset (Go-Ahead), its major competitor. Bournemouth Transport would therefore have needed to negotiate bus station charges and disclose to the bus station operator its intentions in advance, which Bournemouth Transport considered gave the bus station operator the opportunity to pre-empt its plans and at a lower cost. Transdev considered that access to bus stations were a barrier to entry and that the bus station operator had a competitive advantage because:

- Bus stations provided ‘unique availability for layovers and driver changeovers’ and this justified the ‘sunk cost’ associated.

- Allocation of bus stands was a ‘negotiation between unequal parties’ and could impact on usage and consequently service viability, eg proximity to the main entrance.

- Bus station operators could provide office and canteen facilities to its own staff, which competitors needed to provide for their own but at different and potentially less convenient locations.

- Competitors would need to disclose their intentions to launch new services and negotiate charges with the station operator, with the risk of pre-emptive action by the incumbent.

9.145 Stagecoach told us that it was denied permission to relocate a Bicester–Oxford local bus service from Gloucester Green bus station to the rail station in Oxford (the latter was managed by First Great Western, a rail franchise currently managed by FirstGroup’s rail division) on the grounds that it would compete with the rail corridor. Stagecoach told us, however, that this had not prevented it operating the service from another location in the centre of the city. A Small Operator, [\text{[X]}], also expressed concerns over access to the rail station forecourt in [\text{[X]}] where it wished to extend an inter-urban service, as it feared that the train operator might exercise its right of veto and prevent [\text{[X]}] from running services to and from the station forecourt. However, we do not have further evidence on whether this gave rise to problems in practice. FirstGroup (First Rail manages the station forecourt) told us that it was unaware of any occasions since 2008 when a stand allocation request had been denied. Arriva

\(^{82}\) Bournemouth Transport was 90 per cent owned by Transdev but this stake was sold to RATP in March 2011.
told us that it had ongoing issues in gaining access to the toilets and other drivers’ facilities in the bus station at Milton Keynes.

9.146 Following publication of our provisional findings, a Small Operator, Harrogate Coach Travel (HCT), told us that following its launch of a new service in competition with Transdev, its access to stands at Harrogate bus station, which is owned and managed by Transdev, had been impeded. HCT was not allowed to set arriving passengers down and to pick up new passengers from the same stand, whereas Transdev’s competing service was operated fully from one stand; HCT’s buses could only use the stand for a maximum of 5 minutes and was not allowed to leave buses unattended on the stand, whilst Transdev was allowed to do so. Transdev told us that it applied the same conditions of use at Harrogate bus station to all third party firms, and that it had been intended that HCT buses set down and departed from the same stand but operational problems had arisen as a result of congestion. Subsequent to our provisional findings, Transdev addressed these issues by allocating a new stand to HCT.

Charges for bus station use

9.147 We received a number of complaints that the charges for the use of bus stations were set too high.83 For example, we received evidence of high charges at Bath and Bristol bus stations from Rotala, Somerbus and BNES (see Appendix 9.3). FirstGroup, which manages these stations, told us that these charges reflected the heavy costs of investment in these new facilities. FirstGroup noted that its annual forecast for the Bristol bus station was to make a substantial operating loss. It stated that in any case these were not key facilities: they were used for inter-urban services and on-road alternatives were available.

9.148 We received mixed evidence from other parties: Somerbus told us that having operated its Peasedown to Bath service for a year, it now preferred to operate it from Dorchester Street in Bath rather than the station. Rotala told us that in Bristol, passengers were naturally drawn to the bus station as opposed to bus stands as there was no alternative visible place where other buses could operate from. It was not affected by high charges at either station, as it did not need to use either station for most of its services in the short-term, but expected that long-term, its commercial growth in Bath could be affected by shortage of stands and lack of layover space. It considered that the charges for using Bath bus station were excessively high and might affect the cost of tendering for contracts as tenders required the use of the station. B&NES told us that Bristol and Bath bus stations were key operational centres, and it highlighted what it thought was the inefficient way in which Bath bus station was used by FirstGroup. We saw for ourselves that there was a significant shortage of road space and congestion in the adjacent Dorchester Street. The Bath Bus Users Group complained that the bus station was used as a garage by FirstGroup and that local bus services sometimes had to stop some way from the station. It also said that finding information about buses that did not have the bus station as a terminus was not straightforward. South Gloucestershire District Council also complained of high departure charges at Bristol; it had moved some of its supported services to on-road stops but said that these facilities were inferior to those at the bus station.84 Bristol City Council (BCC) told us that the redevelopment of the station following its sale by FirstGroup had resulted in the loss of parking

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83 In contrast, Go-Ahead, told us that bus station access charges would not be a problem for their operations and that they were not aware that charges for access to bus stations would be a difficulty for other operators (Go-Ahead response to provisional findings, section 4.8.3).

84 Appendix 9.3 paragraph 5.
capacity and consequent layover problems. Access to the station was not a problem for BCC, as all urban services operated from the streets, but there was not much room left on the stops.85

9.149 The evidence we received from both Somerbus and Rotala also suggests that there is very little transparency in the way charges are set at Bath bus station: FirstGroup did not respond in writing to requests for quotes from Somerbus or Rotala. Correspondence between Rotala and FirstGroup showed that Rotala was unable to obtain a quote from FirstGroup, despite making several requests. Somerbus told us that it had been quoted a departure charge of £\[\times\] by telephone nine days after sending a written request for a quote, although this caused them no upset. FirstGroup told us that local management had not been able to find any evidence of such a quote.

9.150 We were also told of bilateral reciprocal arrangements between local bus operators in relation to ‘free’ access or use of each other’s bus station. However, we found these arrangements to be limited to a very small number of bus stations, and so any distorting effect between parties to these agreements and other operators is unlikely to be widespread.

9.151 We undertook an analysis of departure charges at those bus stations which were privately owned and managed by bus operators to determine the level of these charges and whether these charges were justified by the costs involved in running the local bus station. This analysis is detailed in Appendix 9.4.

9.152 We identified 47 bus stations which were both privately owned and operated by local bus operators. We looked at average departure charges levied on local bus services at bus stations operated by local authorities, private companies (which were not local bus operators) and local bus operators. We based our assessment on all the bus stations used by the Large Operators (see Appendix 9.4, paragraph 4).

9.153 We found that the average departure charge was £0.36 per departure at bus stations operated by local authorities; £0.49 at bus stations operated by private companies; and £1.06 at bus stations operated by local bus operators. The average across all three bus station operator types was £0.47. When we assessed departure charges at just the privately-owned bus stations which were managed by local bus operators, the average charge levied on other local bus operators was higher at £1.17 per departure.

9.154 Of the 47 privately-owned bus stations that were managed by a local bus operator, we selected for further investigation those which charged £1 or more per departure. This charge per departure appeared, on the face of it, especially high when compared with both the average charges levied at bus stations operated by local authorities and by private companies.86 For these 17 bus stations, we sought to compare a notional internal departure charge with those levied on third-party operators. We note in making these comparisons that there are substantial differences between bus stations, eg in the facilities they offer. We also acknowledge that

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85 BCC summary of response hearing paragraphs 40 to 43.
86 We focused on charges of £1 or more per departure on the basis that £1 was broadly in line with the average charge levied at all the bus stations (regardless of ownership) operated by local bus operators of £1.06, yet this was 2.0 and 2.8 times higher than the average charge levied at bus stations operated by private companies and local authorities respectively. These figures refer to bus stations for which we have information. Furthermore, since the average departure charge of all privately-owned bus stations (ie excluding local-authority-owned bus stations) operated by local bus operators was £1.17, a charge of £1 would capture bus stations which are both below and above the £1.17 average. We therefore selected for our analysis those bus stations which were: (a) privately owned; (b) operated by a local bus operator; and (c) charged £1 or more per departure to third-party local bus operators.
9.155 Based on the comparisons of the third-party charges per departure on local bus operators, with the residual cost per own departure for each bus station (see Appendix 9.4, Table 4), we found that for 13 out of the 17 bus stations (76 per cent), the charge per departure levied on third-party local bus operators was higher than the residual cost per ‘own’ departure. We found that the third-party departure charge could be from 1.2 to up to 7.4 times the residual cost per own departure, with an average multiple of 2.7 times. We also calculated that if bus station operators levied a departure charge on its own buses at the same level as it did on third-party local bus operators, 12 of our selected 17 bus stations would be generating operating profit margins in excess of 20 per cent.

9.156 We found that for the 17 bus stations we looked at, third-party departure charges bear little relation to costs. In 13 out of the 17 bus stations we looked at, the third-party departure charge was greater than the residual cost for a bus station operator’s own departures. In the remaining four cases, they were substantially below residual costs.

9.157 Bus station operators’ explanations for how they set third-party departure charges are set out in Appendix 9.4, paragraph 25. In most cases, there do not seem to be formal methods of setting departure charges. This is unsurprising given that operators were not able to supply accurate cost and revenue data for the bus stations they operated, and so would be unable to apply precise methodologies accurately.

Conclusions on charges and access to bus stations

9.158 We have identified a relatively small number of instances where an existing local operator that manages a privately-owned bus station has restricted bus station access to a rival in a manner that impacts on that operator’s ability to compete. Such restrictions on access can take a number of forms, including:

(a) discriminatory allocation of stands and/or layover capacity (for example at Harrogate);

(b) poor management of stand capacity and more generally restrictions on the capacity available to new entrants (for example at Worcester); and

(c) restrictions on the ability of drivers to access certain facilities available at the bus station (eg issue raised by Metro in relation to Wakefield bus station).

9.159 While the incidence of these problems associated with access has been limited, this may reflect the limited experience of substantial entry within bus markets. The potential for such problems to arise exists wherever the manager of a bus station has the incentive and ability to use this position to raise a rival’s costs.

9.160 Moreover, we found that the level of departure charges set at bus stations can have the effect of disadvantaging other operators compared with the owner/managing operator. In addition, there is a lack of transparency relating to the pricing of bus station access. High access prices and inadequate transparency in access terms are likely to act as a barrier to entry and expansion.
9.161 We concluded that a new entrant (or an expanding operator) could find itself dependent on the conduct of an incumbent rival operator that manages a bus station in order to allow it to compete effectively against that operator’s services. Where this is the case, difficulties in securing access to a bus station is likely to constitute a significant barrier to entry and/or expansion.

**Access to depot facilities**

9.162 We considered whether gaining access to depot facilities was necessary to enter or expand the provision of bus services in an area, and whether such access was restricted. Several operators\(^{87}\) told us that access to depot facilities was not necessary to enter new areas or expand operations, as other, more basic parking facilities could be used (such as outstations), while maintenance could be carried out at more distantly-located existing depots or subcontracted. National Express also told us that depots could be shared with other transport operators.

9.163 In Appendix 9.5, we summarize the evidence we have received on operators running services without depot facilities in the area. There are also many examples of large operators using outstations to park vehicles, which are then operated locally. These outstations are linked to a parent depot, where vehicles are likely to return for servicing and maintenance, although sometimes local contractors can perform this function. For example, \(^{88}\), and Go-Ahead told us that Go South Coast \(^{88}\).

9.164 While it is possible to use outstations or other parking facilities to run local bus services, we need to consider whether such a mode of entry is likely to allow an entrant to compete effectively against an operator with access to its own depot and associated facilities. Small-scale entry or expansion might be possible without depot facilities. However, we have not seen any examples of a long-term model of operation at a medium or large scale that does not involve depot facilities. Go-Ahead told us that large-scale entry or expansion would in most cases require a new depot. We found that depot facilities would be likely to be necessary for new entry at a medium or large scale into an area, or for expansion to a significant scale by a small operator currently without depot facilities in an area.

9.165 We next considered whether there are any restrictions on establishing new depot facilities, or enlarging existing depots, which might act as a barrier to entry at a large scale or expansion to a significant scale by smaller operators.

9.166 We received a variety of views from the Large and Mid-Sized Operators\(^{89}\) on whether access to depot facilities was difficult in the areas in which they operated. Most of these operators told us that they did not face any problems, both in terms of availability of suitable sites and ability to obtain appropriate planning permission. However, some said that there was more difficulty in accessing large-scale facilities. FirstGroup told us that depots for up to 50 buses could be obtained on industrial estates, where planning policy was not an issue, and which were readily available across the reference area. FirstGroup told us that a depot on a larger scale (approximately 100 buses) would require new construction or the adaptation of existing property ideally located close to the route network. It said that planning restrictions might constrain access, noise and/or lighting which could limit the effectiveness of the facilities to varying degrees, although it noted that in its view

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\(^{87}\) FirstGroup, Arriva, Stagecoach, Go-Ahead: South Coast, Oxford Bus Company and Brighton and Hove, \([x]\), National Express.
\(^{88}\) Go-Ahead response to provisional findings, section 4.9.5.
\(^{89}\) Arriva, National Express, EYMS, \([x]\), Plymouth City Bus, Metrobus, Blackpool Transport Services, Cardiff Bus, Lothian Buses and NCT.
depots of this scale would not typically be required for new entry or expansion. FirstGroup told us that the availability of suitable large-scale sites would vary by locality, influenced by the general availability of suitable land in the area, the economic prosperity of the area and the area’s physical terrain.

9.167 Stagecoach similarly told us that access to depot facilities was more difficult for sites for 50 or more buses. [\textsuperscript{1}]

9.168 Some operators’ responses suggested that developing depot facilities was a problem in some areas, even for small depots. Go-Ahead in Brighton and Hove (Brighton & Hove Bus and Coach Company) told us that there was little scope, if any, for the development of a depot within the city as suitable sites were not generally available. It said that depots could be located outside the conurbation, with outstations located in the city for parking, and so it was conceivable that extra capacity could be found. Go South Coast told us that planning permission could be difficult to obtain in some locations (Salisbury and Swanage), and that land was generally at a premium on the South Coast, although it told us that small new entrants could rent parking facilities from other transport operators. Go-Ahead told us that in many of the other areas in which it operated access to depot facilities was not a problem. Other operators (eg [\textsuperscript{2}], Veolia, and Rotala) told us that depot availability could be a barrier to entry and that they had experienced difficulties in establishing new depots and finding sites close to the areas of operation, although one of these operators told us that depot facilities was not an ‘insuperable barrier’. It was noted by [\textsuperscript{3}] that planning permission could often be denied due to concerns over traffic or the environment, and that costs in establishing a new depot were substantial.

9.169 Stagecoach told us that in some areas access to depot facilities was more difficult than in others due to high land prices (eg Oxford and Stratford) or the rural nature of the area combined with the difficulty of obtaining planning permission (eg Cumbria). It told us that in general there were more available sites in areas that were often classed as ‘good bus territory’, such as Manchester, Newcastle, Liverpool or Sheffield, where there were substantial areas of unoccupied light industrial units or former industrial locations that were no longer used. Arriva also told us that planning permission was easier to obtain in industrial areas.

9.170 Some of FirstGroup’s internal papers suggest that capacity constraints of its existing depots could limit its ability to expand. For example, some documents relating to operations in [\textsuperscript{4}] refer to depot capacity as a ‘very real’ or ‘severe’ constraining factor on FirstGroup’s ability to expand, grow or develop new services. A similar situation was observed in [\textsuperscript{5}], where internal papers said ‘The current depot limitations restrict the ability to expand the network. Unless additional parking can be found in [\textsuperscript{5}] there is no economic way to deliver additional services’.

9.171 We received differing views from Small Operators on whether access to depot facilities limited their ability to expand. Two Tier 1 Small Operators (out of 18 respondents) told us that access to depot facilities was a major factor in limiting their ability to expand their operations, and six said that they had experienced or anticipated experiencing difficulties in accessing depot facilities to allow expansion, but a similar number said that they did not anticipate any such difficulties.\textsuperscript{60} The majority of the Tier 2 Small Operators, however, told us that the ability to open a new depot or the access to appropriate parking and maintenance facilities did not limit their ability to enter or expand into new areas. Out of 195 respondents, 127 said that the ability to

\textsuperscript{60} The remaining operators did not answer this question in a way that gave a yes or no answer, for example because they had not tried to open a new depot and hence did not feel they could answer it.
open a new depot did not limit their ability to expand or enter new areas, compared
with 26 that said it was a large factor. Similarly, 130 out of 198 respondents said that
they were not limited by access to appropriate parking and maintenance facilities
(compared with 25 that said this was a significant concern). We do not know how
many of these respondents had considered expanding their operations in ways that
would need new depot facilities.

9.172 Out of the 91 LTAs that answered our questionnaire, 11 told us that identifying a site
for a new bus depot (including obtaining any necessary planning consent) was a par-
ticular barrier to entry or expansion, 11 told us that it might be a barrier, 57 told us it
was not a particular barrier, and 12 told us that they did not know.91 These LTA
responses suggest that access to depot facilities may be a particular barrier to entry
or expansion in some areas.

Conclusions on access to depots

9.173 In conclusion, we find that depots are required for entry on a significant scale,
although alternative methods such as outstations can be utilized for smaller-scale
activities. Outstations can be viable when the distance to a parent depot is not large.
The evidence from operators and LTAs suggests that the ease of accessing depots
varies substantially across the reference area. In many areas, depots were available
or could be established, although sometimes operators may have to compromise on
scale or location (for example, distance from the central operating area). In some
areas, suitable sites, particularly for large-scale depots, are difficult to obtain. We
have not sought to define these areas; it is difficult to assess whether there is a
particular problem in a given area in advance, and it may take just one site to
become available at the right time for the problem to be overcome; but we note that
the evidence suggests that in some cases this restriction can arise.

Costs, economies of size, scale and density

9.174 We now consider the nature of costs involved in the operation of local bus services,
and in particular whether there are any economies of scale or density.92 If economies
of scale or density are significant, a larger operator will have a significant cost
advantage over smaller operators, and so a single operator would be better placed to
provide the same local bus services than two or more competing operators. More
concentrated market structures are likely to emerge as multiple operators on a route
or in an area will face proportionately higher costs. Consequently, only larger-scale
entry is likely to be a viable competitive constraint. This may require the entrant to
displace an incumbent for entry to be successful. Such entry would carry high costs
and risks. We now assess whether such economies of scale and density are found in
practice.

9.175 Large Operators told us that Small Operators might benefit from lower costs. This
can be because they avoid some management costs and overheads associated with
larger groups, and sometimes they may offer a lower quality service such as using
poorer-quality vehicles. For example, FirstGroup said that smaller operators could
have a more flexible cost base (including flexible labour arrangements) and therefore
any advantages of economies of scale could be outweighed by flexibility. Arriva
noted that smaller operators may avoid some substantial costs like pension

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91 This is based on CC interpretation of LTA responses.
92 Economies of density are cost effects due to a simultaneous increase in boardings and miles driven, holding the number of
routes, i.e. the network structure, fixed, while economies of scale measure the cost effect of a simultaneous increase in board-
ings, miles and the number of routes served.
schemes, uniforms or training. Go-Ahead said that it was possible for small companies to operate without all the back-up facilities which high-cost operators needed. While these factors may apply, we note that when operators reach a larger size they tend to move away from these ways of operating rather than just replicating them, suggesting that there must be some benefits experienced from being of a larger size. These might include economies in purchasing, better management, greater flexibility arising from size, or the ability to offer a better-quality service to customers.

9.176 In general, Small Operators did not raise significant concerns in relation to diseconomies of scale for Small Operators compared with Large Operators. Only one Small Operator (Kirkby Lonsdale Coach Hire) told us that Large Operators had substantial economies of scale, which prevented it from attempting to compete with Large Operators on commercial services. Some Small Operators told us that Large Operators had greater purchasing power and as such were able to achieve lower prices for fuel, vehicles or spare parts. Three Small Operators told us that they thought Large Operators had higher cost bases than Small Operators. One Small Operator thought that cost advantages of Large Operators (such as purchasing power) and Small Operators (such as lower overheads and lower pension requirements) largely cancelled each other out. ALBUM also told us that Large Operators had greater purchasing power. It said that regulation had reduced Small Operators’ ability to make savings on costs such as wages.

9.177 We undertook our own analysis of economies of scale in two ways. First, we undertook an econometric estimation of costs based on detailed depot-level data for the Large Operators and Transdev for the years 2007 to 2009, as set out in Appendix 9.6. Second, we compared cost ratios at depot level for large and medium-sized operators, and making some comparisons with cost ratios at the company level for smaller operators (see Appendix 9.7). We looked at the costs of operating different scales of depots as these will tend to be the unit by which an operator will enter a local area. Systematic and comparable information on the costs involved in entry was not available.

9.178 This analysis has necessarily concentrated on analysis of depot costs where detailed information has been available and so is largely based on comparison of different depot sizes for larger companies. Where our analysis is restricted to coverage of these larger companies, it does not directly tell us about the costs of smaller companies and so how their costs will compare.

9.179 We are aware that entry may be via small scale operations, possibly using limited depot facilities or just parking facilities with support functions subcontracted to other suppliers. However, if this was a particularly cost-effective way of doing business, we would expect to see successful companies adopting this technique. But this is not a model we generally see among established businesses, which, if they are operating at a significant scale, tend to invest in dedicated depot facilities rather than replicating this outsourcing methodology. We therefore do not expect that small-scale depots or outsourcing depot functions is in the long term a cost-effective way of doing business. The exceptions to this arise only where the scale of operation justified by the size of the local area being served is very small.

93 Munro’s of Jedburgh, Tanat Valley Coaches, Shuttle Buses, Thames Travel.
94 Kirkby Lonsdale Coach Hire, Tanat Valley Coaches, Shuttle Buses.
95 Munro’s of Jedburgh.
96 Speedwell Bus, Moffat and Williamson, Thames Travel.
97 Munro’s of Jedburgh.
9.180 We modelled the relationship between the total costs at a given depot and several dimensions of output (boardings, miles driven and the number of routes served), taking into account the influence of other factors such as local demographics and density of the bus and road network.

9.181 The results in Appendix 9.6 are consistent with the hypothesis that an average depot of one of these six bus operators does not face economies of scale and density. To test the importance of depot size, we also estimated the relationship between total costs at a given depot and output, looking at small, medium and large depots. We found that small depots\(^{98}\) face moderate economies of scale and density. Medium-sized and larger depots appear to have largely exhausted any such economies. In other words, when placed in identical conditions, a small depot would have average costs which decrease if output is increased, while average costs at a large depot remain unchanged if output is increased. We based this conclusion on analysis of information relating to small depots of the major operators, and therefore we cannot say with certainty whether this cost disadvantage would also apply to small depots operated by small and mid-sized bus companies.

9.182 Oxera, on behalf of Stagecoach, submitted an analysis of costs based on Stagecoach data. The results of Oxera’s analysis appear to be broadly consistent with our own findings, in that it found on average small economies of scale for Stagecoach depots. When our size categorization is applied to Oxera’s analysis, Oxera’s results show that economies of density and scale are largest for Stagecoach’s small depots, smaller for Stagecoach’s mid-sized depots and smallest for Stagecoach’s large depots. It is, however, worth noting that Oxera’s econometric approach differs from ours (see Appendix 9.6, paragraphs 45 to 49, for a more detailed discussion).

9.183 The DfT drew our attention to research on bus costs it had commissioned from the Institute of Transport Studies at the University of Leeds.\(^{99}\) This was an econometric analysis of Stats100a data over the period from 1999 to 2006. This found that there were ‘mildly increasing returns to scale’ in the provision of bus services with returns to scale ‘increasing as firms get bigger’. However, we noted that the Stats100 data has less coverage of cost data than the information which we were able to gather. For example, it does not account separately for different factor costs, such as labour cost, capital cost or materials cost. In our view, the analytical techniques we have adopted in the context of this more detailed data is likely to yield more reliable results.

9.184 The depot cost comparison (see Appendix 9.7) is a simple comparison of average cost measures at a depot level against indications of scale at various levels, without controlling for the influence of other relevant factors. It looked first at the effect of scale at a local level, to see if larger depots benefited from lower costs than smaller depots. It then looked at the impact of scale at a group level, to see if the depots of the larger groups had lower costs (eg through better purchasing or more efficient management) than the depots of the smaller operators. To enable us to compare cost between depots of different sizes, we calculated a range of cost ratios for each depot, including cost per km, cost per hour, cost per PSV, etc.

9.185 On our assessment of local scale effects, we categorized each operator’s depots into small, medium and large size categories, based on the annual total miles operated by the buses at each depot. Our analysis showed that average costs tended to

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\(^{98}\) Defined as depots where the total number of passenger boardings was fewer than 3.8 million a year.

increase as the depot size increased—see Appendix 9.7, Table 1. However, individual cost ratios for each depot showed that larger depots could incur higher costs than smaller depots and vice versa.

9.186 We also looked at group scale effects to see if the depots of the larger operators (at a national level) benefited from lower costs than the depots of the smaller operators. To do this, we categorized depot ownership into three categories: those owned by Small, Mid-Sized or Large Multi-Regional Operators—see Appendix 9.7, Analysis 2. Our analysis resulted in inconclusive findings. Whilst on average the depots of the Large Multi-Regional Operators benefited from the lowest costs, the wide-ranging values for each cost ratio around the average meant that a depot of one of the Large Operators did not necessarily benefit from lower costs than a depot of a smaller operator. The wide variation in cost ratios between depots suggests that there may be a number of factors (eg local area features and differences in the types of local bus services) which affect the level of costs at a depot. When we compared costs between depots in a number of sample local areas to incorporate an element of control for local market factors, we found indications that smaller operators could face higher or lower costs than larger operators in the same area (see Appendix 9.7, Annex A).

Conclusions on costs, economies of size, scale and density

9.187 In conclusion, having analysed data obtained from six operators (the Large Operators and Transdev), we find some evidence that small-scale operations are likely to experience some economies of scale and density. However, these are exhausted for medium- and large-scale depots. These results arise from econometric analysis of the multi-regional operators’ depots only, and so does not provide evidence of how costs faced by smaller operators may compare, and excludes non-depot-based operations. Nonetheless, we note that larger operators tend not to use several small depots where a medium or large depot could be used, and they tend not to use outstations or subcontracted maintenance except where the scale or operation is very small. We also note the ITS study detailed in paragraph 9.183. The qualitative evidence we have received is inconclusive in that smaller operators may face lower costs in some respects (eg lower labour costs) but may face higher costs or lower efficiencies in other regards. Overall, we cannot conclude that small-scale operations in a local area are likely to be significantly disadvantaged by higher costs relative to a larger-scale rival.

Regulation

9.188 We also considered whether the policy and regulatory environment relevant to the operation of commercial local bus services raised any barriers to entry or expansion. This could arise if policy and regulation affects a new entrant or expanding operator more than it would an incumbent. Our consideration of possible barriers to entry and expansion is set out in Section 12 in the context of an assessment of the overall effects of policy and regulation on competition in local bus markets.

9.189 There will be some costs involved in understanding and complying with the regulation that applies to this industry, including, for example, the concessionary fares schemes in different areas. Several operators told us that the overall burden of regulation in the industry was excessive and so may impede operators’ ability to operate bus services and may deter entry. However, as explained in paragraph 12.79, we do not find that this possibility constitutes a barrier to entry and expansion.
9.190 We were also told that the need to obtain an operating licence could limit the potential for entry. In particular, the requirements for establishing appropriate financial standing were considered to be too demanding and discriminated against smaller operators in that larger operators could more easily demonstrate their standing. This is discussed in paragraphs 12.32 to 12.38, where we conclude that the regulations do not impede competition. Bus services must also be registered with the Traffic Commissioner in advance of commencing, changing or withdrawing operations, and concerns were raised that this could impede competition, that notice to withdraw services could act as a barrier to exit, and that the different requirements for registering changes in frequent services could distort competition between frequent and timetabled services. This is set out in paragraphs 12.39 to 12.49. No direct adverse effects on competition were identified. However, we were concerned that operators of services which qualified as frequent services could increase frequency to an unlimited extent on the relevant route in response to entry or expansion by another operator with no notice period, and that this could contribute to the barriers associated with post-entry competition (see paragraph 12.49).

9.191 Aspects of voluntary and statutory partnerships are discussed in paragraphs 12.87 to 12.99, and qualifying agreements in paragraph 12.97. Such schemes are subject to a competition test. We have not found an adverse effect on competition.

9.192 Some Mid-Sized and Small Operators told us that due to historical reasons some bus operators had closer links to local public bodies, which distorted competition in the area and might give larger incumbents an advantage compared with new entrants or smaller expanding operators, which would act as a barrier to entry or expansion. The Big Lemon told us that publicly-funded organizations, such as universities and local councils, often had internal systems, websites and relationships in place which favoured incumbent operators, and so there was not a level playing field for entrants. For example, there were suggestions that new operators may not have equal access to publicity through these organizations’ information about public transport, and they might not be granted similar rights of access to university campuses. We note that this has not been raised as an issue by other operators, and in most cases it was unclear what competitive advantage would arise from relations with particular local public bodies.

9.193 [ Hakuna Matata ] told us that some companies (such as [ Hakuna Matata ] in its area) remained largely or wholly owned by the local authority and were therefore funded and operated differently from private sector concerns. It said that the situation could therefore arise whereby the authority-owned/controlled business would retain routes or parts thereof that were socially or politically sensitive rather than commercially viable. We have also seen that Municipal Operators tend to have different objectives from normal commercial operators. This could restrict the ability of other operators to compete with them, and [ Hakuna Matata ] said that this would constrain the market for tendered contracts.

9.194 We note that some Municipal Operators are not required to deliver commercial rates of return, see the municipal operator profiles in section 3. This could help them compete against other operators, or may lead them to take actions that Non-Municipal Operators might not, for example providing services that a Non-Municipal Operator might consider uneconomic. However, we did not see evidence to suggest that this had had any significant distortionary effects on competition.

Conclusions on regulation

9.195 In conclusion, as set out in Section 12, we find that aspects of policy and regulation applicable to local bus services, while attracting some compliance costs, do not tend
to have a greater impact on a new entrant or expanding operator compared with an existing operator and as such do not raise additional barriers to entry or expansion.

**Local knowledge and effective local management**

9.196 Several operators told us that local knowledge and effective local management were important factors behind successfully operating local bus services. FirstGroup told us that successfully running local bus services required detailed knowledge of the local area in which those bus services operated. Arriva also suggested that a local knowledge base was important, and that this might be a reason why operators could be reluctant to enter new areas.

9.197 We considered whether entrants were disadvantaged relative to incumbents in their ability to design and operate services that were targeted at viable market opportunities.

9.198 A lack of local market knowledge might make entry more risky, if a new entrant is unsure about the demand on a new route, features of the road and bus network, how to plan and manage services, etc, and hence unsure about how best to set its offering to serve that demand and/or compete with an incumbent operator. FirstGroup told us that it relied on the local knowledge of its operating companies’ managing directors and commercial teams in order to understand the many and varying features of its routes. Stagecoach told us that its local knowledge was one reason why it had a strong position in the areas in which it operated.

9.199 In theory, a lack of local knowledge could act as a barrier to entry for a new entrant to operate local bus services. However, this factor would not be expected to apply to expansion by an existing operator, and so would not be relevant to expansion or potential competition.

9.200 FirstGroup, Go-Ahead, Stagecoach, Arriva and National Express all said that while local knowledge was important in starting a service, it was immaterial as a barrier to entry. They said that operators came from an industry background so already had industry knowledge. Stagecoach said that given an industry background, local knowledge was very easy to pick up as the industry was so transparent. For example, it was reasonably easy to observe passenger loadings on existing services. Arriva and National Express both said that new entrants were often former employees of existing bus operators, and hence would already have the required local knowledge and management expertise. We also note that entrants may be able to recruit staff from an existing operator in the area to provide some local knowledge.

9.201 An operator contemplating significant entry into an area may also do this through acquisition and subsequent expansion.

**Conclusions on local knowledge and effective local management**

9.202 We conclude that local knowledge and effective local management does not form a barrier to entry and expansion.

**Acquisitions**

9.203 There have been many examples of operators entering areas through the acquisition of an existing operator rather than through de novo entry. A change of ownership
does not of itself increase competition in a market if it does not change the overall level and nature of supply in the market.\textsuperscript{100} However, acquisition can provide a base for subsequent expansion. The change of management may also alter the way in which the operator competes which could make it more or less effective as a competitor. Acquisition by a larger operator may also increase the financial resources available that would allow it more effectively to overcome barriers to entry and expansion offered by the threat of responses to entry. As noted in paragraph 8.163, the constraint offered by potential competition can be more effective where the potential competitor is a Large Operator or part of a large group. Therefore, acquisition sometimes has the effect of changing the constraint from potential competition.

9.204 We found that acquisition as a route to entry reduces the potential barriers to entry and expansion. For example, it provides access to depot facilities, there may already be an existing network of services providing sufficient scale, and reduces or eliminates the costs of raising new routes up to maturity. In acquiring an existing operator, the purchaser is also acquiring local knowledge and brands or marketing, and the sunk costs of entry are avoided. On the other hand, such benefits are likely to be reflected in the valuation of the company which is being acquired.

9.205 We have in a few cases seen examples of operators considering the acquisition of routes or depots from each other. In some respects, the sale of routes seems peculiar because there are no property rights attached to routes; any operator can register a new service. In some cases there has been some associated sale of staff or vehicles, but in other cases the only tangible benefit seems to be a direct reduction in head-to-head or potential competition, and an agreement not to compete on that route for a period of time. We also note in paragraphs 8.207 to 8.212 that these transactions could form part of a process of geographic segregation between operators.

**Geographic scope of barriers to entry and expansion**

9.206 Any local bus operator considering entering into head-to-head competition on a particular flow will face a material risk that this entry will result in overcapacity and significant losses. Overcapacity arises from the entry itself if a route was previously well-served, plus any capacity responses from the incumbent (and any subsequent further responses by the parties to each other’s actions). These losses will represent, in effect, a sunk cost of entry. The incentive to increase capacity arises from customer conduct identified in paragraphs 8.49 and 8.50. Because customers everywhere behave in this way, the barriers to entry associated with it are also present in every relevant market.

9.207 We identify above two particular barriers to entry associated with this conduct:

(a) Sunk costs of entry—all entrants face a risk that it will take time for their new service to reach profitability and the losses made during this period represent a sunk cost to the entrant.

(b) The expected intensity of post-entry competition—all entrants will face the risk that the incumbent operator will react to their entry and that their entry triggers a period of unstable competition which could lead to large unrecoverable losses.

\textsuperscript{100} Unless the purchaser is already present in which case competitive constraints are directly reduced, or there is any coordination between particular operators.
Operators have pointed out that some routes achieved profitability relatively quickly and the sunk costs turned out to be small, and have pointed to instances where entry did not trigger a response from the incumbent or did not lead to a period of unstable competition. We recognize that the costs associated with these barriers may or may not be realized in practice; what is relevant as a barrier is that a potential entrant will not be able to predict in advance whether or not these costs will arise and their extent. Moreover, if it takes a long time for a route to build custom and achieve profitability, and if entry leads to intense competition, the size of these costs might be high. Therefore the risk of incurring these costs is likely to be perceived as significant, and it is these uncertain but potentially significant costs that act as the barrier. However, the size of the barrier might vary with some identifiable characteristics. For example, some operators may be known to have greater resources to survive intense post-entry competition or greater incentives to bear such costs. This uncertainty is particularly significant in the case of local bus services compared with other industries because of particular aspects of these markets, such as the potential for intense competition on the basis of capacity to arise and the ability of incumbent operators to choose to exacerbate this further for strategic reasons, and the nature of customer conduct.

Other barriers to entry and expansion can apply in individual cases to varying extents depending on the particular circumstances. Of these, within-route network effects are likely to be widely applicable.

Conclusions on barriers to entry and expansion

We conclude that there are a number of barriers to entry and expansion in the supply of local bus services which have the effect of reducing the strength of entry or potential competition as constraints on competition in the markets for the supply of bus services.

We identified two particular barriers to entry and expansion which would be likely to apply to all entrants across the reference areas, see paragraphs 9.206 to 9.209.

The first of these arises from the sunk costs of bringing a route to profitability. These costs are difficult to predict in advance and will, for example, depend on the nature of competition post-entry (see paragraph 9.213). This applies to both new entry and potential competition. The expectation of sunk costs which are potentially significant, whether or not they materialize in practice, forms a barrier to entry and expansion that will apply in all cases.

The second of these, and closely related to the first point, is the barrier to entry and potential competition from the expected intensity of post-entry competition which depends on the anticipated response to entry from incumbent operators. The likelihood of vigorous post-entry competition will depend on the trade-off between the expected benefits and cost of such aggressive competition as compared with accommodation of entry. As explained in paragraph 9.38, in addition to higher profits on the given route in the case of successful deterrence, benefits of such deterrence include reputation and signalling while differences in the access to financing may make such deterrence possible. There is an expectation of a period of unsustainable competition, resulting in a process which increases costs and risks for the entrant; consequently entry might be deterred in the first place. Although we note that responses do not always occur, where they do occur they can substantially increase the costs and risks involved in entry and may deter entry. In cases where competition results in service frequencies increasing, the outcomes may become unsustainable and loss-making for both the incumbent and entrant, in which case it is likely that one or other would exit. We acknowledge that a powerful well-resourced entrant could do
the same to try to weaken and evict an incumbent and there are many examples of aggressive competition adopted by both entrant and incumbent.

9.214 A vigorous competitive response to new entry is likely to increase with the scale of entry (whether new entry or potential competition), as small-scale entry may be considered not worthy of significant reaction whereas large-scale entry creates a much greater threat to the incumbent. Large-scale entry may of itself create over-capacity on overlaps, which may then be followed by a reaction that further increases frequencies. Conversely, entrants which are large in terms of their overall operations relative to the incumbent may be better placed to survive post-entry competition regardless of their scale of entry in a particular area. Consequently the effect of this barrier can vary depending on particular circumstances. However because incumbents’ reactions, and their willingness and ability to sustain them, are unknown in advance, and because the costs that would then be incurred could be substantial, the perception of the risk of such reactions is always likely to apply when entering in competition with an operator’s existing services.

9.215 There are several other barriers to entry and expansion that are likely to occur in some cases.

9.216 First, entry may in some cases also give rise to strategic retaliation from the incumbent on other routes, intended to either impose costs on the entrant so that it withdraws or to deter any further entry. Such retaliation only occurs in some cases; however a potential entrant will not know in advance whether such retaliation will occur. Probabilities will depend on the relative scale and resources of the operators and the extent to which their services overlap or are close enough for retaliatory actions to be feasible, and whether the incumbent is likely to think such actions would be worthwhile. Therefore there are uncertain and potentially significant costs arising from the possibility of post-entry retaliation.

9.217 Second, new operators or operators with limited and relatively infrequent services face network and ticketing barriers relative to larger incumbent operators. The existence of ‘within-route’ network effects on most routes, mean that small-scale entry with a relatively infrequent service at a route level will tend to leave the entrant disadvantaged relative to larger incumbents, where their services overlap substantially. In larger and more complex Urban Areas, network size may also be a significant competitive factor and represent an additional barrier to entry and expansion. In these Urban Areas, network operators have a significant advantage which can be reinforced through their sales of network tickets. This makes small-scale entry relatively ineffective. Network and ticketing advantages are reinforced where multi-operator tickets are not well used, for example because of their pricing, or other factors limiting their attractiveness to customers. Larger incumbent operators may have an incentive to use their influence on the governance of multi-operating ticketing schemes to limit the attractiveness of these tickets.

9.218 There are several other barriers to entry which only arise in certain circumstances. Access to depots was not generally identified as a problem other than in a few areas where there are few suitable sites available and getting planning permission may be difficult.

9.219 We identified some cases where access and charging to bus stations could restrict the ability of a new entrant to compete. This arises where an incumbent operator manages bus stations and has the incentive and ability to set departure charges or

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9-47
restrict access so as to disadvantage competitors. This barrier will apply to both new entry and expansion.

9.220 We also find that ‘cheap exclusion’ can represent a barrier to entry, see paragraph 9.36.

9.221 We have not identified significant barriers in relation to economies of scale although operators of small depots may be disadvantaged to some extent. Nor have we identified barriers in relation to local knowledge, and policy and regulation. We have found that there are some other sunk costs (other than those discussed in paragraph 9.212, for example staff training, developing vehicles and depots, and branding and marketing). Such costs are likely to increase in line with the scale of entry, although costs will be less marked where this is based on expansion of an existing facility. However, the evidence does not suggest that the scale of these sunk costs is high, see paragraph 9.32.

9.222 The effect of these barriers is likely to vary locally and according to the nature of entry or expansion contemplated. Smaller-scale entry, which is what we have observed in a number of local areas, is not affected to the same degree as large-scale entry and expansion. This is more difficult than smaller-scale entry and expansion for several reasons. First, large-scale entry and expansion is more likely to stimulate a competitive response from incumbents (which may result in competition resulting in the withdrawal of the entrant or incumbent). Second, large scale entry or expansion is likely to involve larger sunk costs. Third, large scale entry or expansion is more likely to involve difficulties in gaining access to suitable depot sites (and possibly to bus stations). However, large-scale entry and expansion might offset some ticketing and network advantages that an incumbent operator holds. Although some barriers would remain, expansion using existing facilities is generally likely to face lower barriers than new entry, because of lower sunk costs, no need to develop a new depot, and possible existing network effects.

9.223 One entry tactic can be to bid initially for tendered services. If successful, this can provide a base level of business, from which an operator can subsequently expand into commercial services. Such a tactic would reduce some of the risks involved in entry, as for the initial entry, supported services provide a greater degree of commercial certainty, and there is a reduced risk of generating a competitive response from rivals (see paragraphs 13.122 to 13.137). Subsequent expansion into commercial services would then be less risky than completely new entry if there is already a base of business underpinning the operator. However, an entrant may be at a disadvantage in bidding for services where an incumbent has a significant level of sales of network tickets which the supported service operator is then required to honour (see paragraphs 13.91 to 13.96).

9.224 Several operators told us that in their view, barriers to entry are low, and the significance of barriers to entry could not be squared with the number of operators present in the industry, the examples of entry identified and the expansion of some

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102 See paragraph 6.74.
103 For example, Stagecoach response to provisional findings, paragraph 1.3, Arriva response to provisional findings, paragraph A9.
smaller operators over time.\textsuperscript{104} It was also put to us that the CC had not established the size and impact of any barriers to entry.\textsuperscript{105}

9.225 Our assessment of barriers to entry and expansion is, by necessity, qualitative. It is not possible to quantify the impact of barriers to entry and expansion on entry rates, as we cannot observe entry rates in the absence of any barriers, and moreover the interpretation of entry rates is not clear—low rates of entry are consistent with the presence of barriers but also with an absence of entry opportunities if entry were an effective constraint. Quantification of the scale of barriers is also difficult, in part because some of the primary barriers identified (on sunk costs of entry and expectations of post-entry competition) relate to the expectation of possible but uncertain eventualities, and because the incidence of barriers depends on particular local circumstances.

9.226 In conclusion, we have identified a number of barriers to entry and expansion as detailed in paragraphs 9.210 to 9.220. The size of these barriers can vary, depending on particular circumstances. The effect of these barriers is to reduce the probability that entry or expansion will be attracted by a market opportunity. This, in turn, will reduce incumbents’ perception of the constraint posed by the threat of entry or expansion, but this does not guarantee entry will definitely not occur. Whether or not entry will actually occur depends on particular circumstances, but barriers to entry and expansion reduce the likelihood of this happening. In combination with our findings in paragraphs 6.74 and 6.75, that many areas have not experienced new entry, this indicates that the constraint from new entry is limited by these barriers. We also find that some of these barriers impede the constraint from potential competition. In some areas expansion may also be constrained by geographic segregation.

\textsuperscript{104} For example, FirstGroup response to provisional findings, paragraph 3.1, Arriva response to provisional findings, paragraphs B3-18, B3-55, National Express response to provisional findings, paragraph 4.6; Operators identified 638 instances of expansion within existing areas by Large and Mid-Sized Operators and Centrebus or entry/expansion by Small Operators; see paragraph 6.81.

\textsuperscript{105} National Express response to provisional findings, paragraph 4.14, Stagecoach response to provisional findings, paragraph 4.6.
10. Profitability

Introduction

10.1 In this section we set out the work that we have done to assess the profitability of local bus operators. We considered the profitability of local bus operators at two levels: national (UK excluding Northern Ireland and London) and local. We consider each of these strands separately. Under each strand of analysis we explain the role of the analysis in our investigation; the methodology adopted; and the results of the analysis.

10.2 This section is supported by further details and analysis set out in:

(a) Appendix 10.1 Bus industry profitability;
(b) Appendix 10.2 UK local bus industry cost of capital;
(c) Appendix 10.3 Analysis of operator profitability; and
(d) Appendix 10.4 Bus industry profitability at depot level.

National profitability

The role of profitability analysis in the market investigation

10.3 An important indicator of the extent of competition in a market is the level of profits of the firms involved. A competitive market is likely to generate significant variations in profit levels between firms and, at particular points in time, the profits of some firms may exceed the cost of capital. Reasons for this could include: cyclical factors; transitory price or other initiatives; the fact that some firms may be more efficient than others; and the fact that some firms may be earning profits gained as a result of past innovation. Notwithstanding cyclical and transitory factors, competition should put pressure on profit levels, so that they move towards the cost of capital in the medium to long run. However, where profits have been persistently in excess of the cost of capital for firms that represent a substantial part of the market, this can be an important indication of limitations in the competitive process.

10.4 Our existing guidelines\(^1\) identify a situation in which profits are both persistently and substantially in excess of the cost of capital as an indication of limitations in the competitive process. The strength of this indication may depend on both the size of the gap between the level of profits and the cost of capital and the length of the period over which a gap persists. We consider that the longer that profits have exceeded the cost of capital, and the higher the amount by which they have exceeded the cost of capital, the more likely they are to indicate problems with competition in their own right.

10.5 All things being equal, a very large gap between the level of profitability and the cost of capital will tend to indicate a more pervasive and significant problem than a situation in which the gap is smaller. In the latter case, it will be important to interpret the evidence on profitability in conjunction with other information about the operation of the market. For example, in any market investigation we need to have regard to the nature of the industry we are looking at. Mature industries with stable investment

\(^1\) See the CC’s guidelines for market references (CC3, June 2003), paragraph 3.82.
profiles may be expected to exhibit different patterns of profitability to those for example undergoing a period of expansion or rapid technological change.

10.6 We will also be interested in the trend in profits over the period under examination. Where the size of the gap between the level of profitability and the cost of capital has grown over a period this may indicate deterioration in competitive conditions.

10.7 As with other types of analysis, we will take account of the quality of our estimates of profitability and the cost of capital when making inferences from them. We recognize that no assessment of this nature can be exact; assumptions and judgements are necessary in all cases. We approach these assumptions and judgements conservatively. In cases where, having undertaken a careful analysis, we are able to estimate the level of profits and cost of capital with confidence, we are likely to view a smaller gap between them as being sufficiently material to indicate limitations in competition than would be the case if there were more uncertainty around our estimates. This indicates that the interpretation of the size of the gap between profitability and the cost of capital may depend both on our view of the quality of our estimates and on other evidence about competitive conditions.

10.8 We do not always seek to assess the reported level of profitability of the firms currently in the market. We may make adjustments to actual profits to reflect the level of profitability that may be earned by a hypothetical efficient stand-alone operator. Hence we would seek to adjust where possible for company-specific factors that would not necessarily be faced by a stand-alone operator or a new entrant in a competitive market. This is because it is the underlying level of profitability that is relevant. However, we are mindful that in most cases, actual company data provides the most reliable estimate of the revenues and costs likely to be faced by a new entrant.

10.9 Our national analysis assessed the profitability of the Large Operators over a five-year period. These operators together accounted for around 70 per cent of the reference market, with four of the five being significant Multi-Regional Operators with activities across the UK. Arriva and FirstGroup argued that we should look at the industry as a whole. Our guidelines, however, state that we assess the returns of firms which represent ‘a substantial part of the market’, not necessarily the returns of the market as a whole. In our view, the five largest operators’ market share of around 70 per cent constitutes a ‘substantial part of the market’.

10.10 As part of our national analysis, we also looked at whether there was evidence of a systematic difference between the profitability of the Large Operators and the Mid-Sized Operators. Such a difference could be an indicator of market power or economies of scale.

2 Section 2, Table 2.14. [X] estimated that the five largest operators constituted 68 per cent of the UK local bus market outside London.
3 Response to provisional findings.
4 See the CC’s guidelines for market references (CC3, June 2003), paragraph 3.82.
5 We use the term ‘substantial part of the market’ in this circumstance to refer to the running by operators of local bus services in single or multiple locations such that they have, when these services are amalgamated, a substantial part of both the total of UK local bus services by revenue and the proportion of services within local areas in the UK.
National profitability—methodology

Profitability measure

10.11 Our central measure of profitability was pre-tax return on capital employed (ROCE). We used modern equivalent asset (MEA) values in our assessment of capital employed. This approach is in line with our guidelines and has been used in previous market investigations. We considered the use of alternative measures including truncated internal rate of return (TIRR) but concluded that ROCE was the most practical and suitable method in this investigation given the maturity of the industry, the stable nature of the main operators’ businesses within it, and the difficulties in determining accurate and consistent cash-flow data for all the main operators’ UK local bus businesses. We considered in this case that, providing appropriate adjustments were made to the accounting data used to calculate ROCE, it could be expected to produce similar results to a TIRR-based approach.

10.12 The majority of operators agreed that ROCE was the appropriate measure for assessing profitability. A few operators argued that EBITDA and EBIT were the primary measures of profitability in the industry and therefore were more appropriate for our analysis. However, in our view ROCE is a better measure of profitability for the purposes of a competition investigation, because it is a comprehensive and widely understood measure with a strong theoretical base which enables a direct comparison to be made to the cost of capital. Neither EBIT nor EBITDA provide a comprehensive measure of profitability including a return on capital.

10.13 We acknowledge that alternative measures are useful in assessing aspects of individual operators’ performance and making comparisons between operators. As such, we have looked at EBIT and EBITDA in understanding movements in returns for individual operators and for comparing average returns between Large and Mid-Size Operators where capital employed data was limited (see paragraphs 10.54 to 10.57). We have also used similar profit and loss account measures in our local analysis.

10.14 Our analysis looks at the historical profitability for the Large Operators over a five-year period, starting with the first accounting period ending on or after 31 December 2005. It is retrospective. We do not attempt to forecast future profitability. As such, we have not specifically taken into account known future changes in EU legislation and domestic law (eg DDA) which may have an effect on future profitability. However, as a consequence of using MEA values, we reflected some of the costs of compliance with future legislative changes in operator profitability. This may lead to the asset values being overstated and, as such, profitability being understated. The basis of the MEA valuation is discussed in detail in paragraphs 10.17 to 10.26.

10.15 We consider that the five-year period chosen is both a reasonable and representative period over which to assess profitability. We believe that the five-year period used is sufficiently long enough to allow local bus operators to respond to market signals through entry, expansion or a change in offering and as such, for us to determine whether a pattern of profits in excess of the cost of capital occurs over a sustained period.

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6 CC3, paragraph 3.84. The guidelines state that ‘normally in measuring profitability the Commission’s approach will be to start with accounting profit produced in line with UK generally accepted accounting practice and then make adjustments’.
7 NCT, National Express.
8 Arriva argued that such regulation inevitably increased the investment and cost of assets in the future. As such, this additional cost would need to be taken into account in cash-flow planning and hence the returns necessary to be earned from operations.
9 For example, buses have to comply with the DDA legislation between 1 January 2015 and 1 January 2017 (depending on whether the bus is single or double decked). As a result, the current purchase cost of a bus used for MEA valuation purposes will probably be the cost of a DDA-compliant rather than a non-DDA-compliant bus given that an operator is unlikely to buy a new bus with a life of 12 to 15 years which it will not be able to operate after 1 January 2015/2017.
period. As part of our consideration, we looked at the listed Large Operators\textsuperscript{10} published financial accounts for evidence of any significant post period changes in performance. Such changes might indicate that the period under review was not a representative period over which to assess profitability. As set out in paragraph 10.48, we found that the listed Large Operators all reported an improvement in operating margins in the year following our five-year period.\textsuperscript{11}

**ROCE calculation principles**

10.16 In the following paragraphs, we set out a summary of the principles we adopted in relation to the assumptions that we made in our ROCE calculations. A detailed discussion of our ROCE calculation methodology is included in Appendix 10.1. We asked the five Large Operators to provide data in accordance with these principles. We also gathered information from a variety of other sources to assess and test the application of these principles.\textsuperscript{12} To take account of individual operator factors, we also undertook sensitivity analysis. Where appropriate, we made adjustments to operators’ ROCE calculations. As a result, we consider that our methodology is appropriate and our results are robust.

**MEA values**

10.17 In order to compute ROCE, we needed to establish an appropriate value for capital employed, recognizing that the historic cost of assets may not be economically meaningful for our purposes. Returns based on the historic cost of assets may result from a combination of changes in asset values due to price changes or technological changes and economic returns generated by the business activities employing those assets. To calculate the economic returns it is necessary to use the MEA value, ie the lowest cost of purchasing assets today that can deliver the same set of services as the existing assets. This provides a consistent basis on which to compare profitability, irrespective of when the firm acquired its asset base. It can be viewed as the investment required for an expanding incumbent or a new entrant to replicate the services on which the return is earned as efficiently as possible. Thus if returns are high when calculated on this basis, they should theoretically provide a signal for market entry.

10.18 The main classes of assets which were adjusted for MEA values were buses and land and buildings. Buses accounted for around three-quarters of operators’ fixed assets with land and buildings around one-quarter. Other fixed asset classes were not material. We asked the operators to provide details of their fixed assets on both a book and MEA basis. We set out in the following paragraphs the main considerations we took into account when assessing the data provided by the operators.

- **Buses**

10.19 Buses can be used by operators for significant periods of time,\textsuperscript{13} leading to differences between book values and MEA values as a result of inflation and technological developments. This means that book values in this case would not be a reasonable proxy for MEA values. MEA values can sometimes be approximated using published

\textsuperscript{10} The listed Large Operators are: FirstGroup, Go-Ahead, National Express and Stagecoach. Arriva delisted when it was acquired by Deutsche Bahn AG in August 2010.

\textsuperscript{11} Figures provided to us by Arriva show that its operating profit for its UK bus region for the year ended December 2010 is in line with previous years.

\textsuperscript{12} The sources of data used in our analysis are set out in Appendix 10.1.

\textsuperscript{13} The average life cycle of a bus is between 10 and 15 years.
second-hand values. Although we noted that there was an active and transparent second-hand market for buses, there was little independently-gathered data on second-hand prices. We found that publicly available second-hand pricing data was not robust or sufficient enough to allow us accurately to value buses of different specifications, at different times in their life cycles. We therefore used cost data provided by the operators.

10.20 Operators generally calculated MEA values for their fleets by calculating a cost per bus for one of the years in the period\(^{14}\) using either the average cost of recent bus purchases or current/tender prices for buses. This cost was then adjusted for the other years in the period using a cost index such as CPI.\(^{15}\) The cost for each bus in each year was then depreciated to reflect the age of the vehicle in that year. The changes in value resulting from the revaluation were recognized in the operators’ asset bases and the change in depreciation plus any holding gain or loss associated with the MEA valuation methodology was reflected in the operators’ profit and loss accounts.

10.21 The exception to this was Go-Ahead: It told us that it believed that in the majority of cases its fleet’s book value was a fair approximation for its MEA value. It did though propose an adjustment to reflect the fact that not all its buses were DDA compliant and as such would need to be replaced. Go-Ahead did not provide data to substantiate the assumptions used in this adjustment. As such, there was significant uncertainty in relation to these figures and we therefore chose in our analysis to calculate MEA ROCE excluding Go-Ahead’s bus DDA revaluation.

10.22 We assessed each Large Operator’s methodology on its own merits and compared the resulting valuations with the other Large Operators. In addition, we compared base costs against data gathered from both Large and Mid-Sized Operators. The averages for Large and Mid-Sized Operators’ costs are set out in Table 10.1.\(^{16}\)

<table>
<thead>
<tr>
<th>Vehicle class</th>
<th>2006–2009 average</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mini</td>
<td>101,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Midi</td>
<td>106,000</td>
<td>110,000</td>
</tr>
<tr>
<td>Single deck</td>
<td>130,000</td>
<td>135,000</td>
</tr>
<tr>
<td>Double deck</td>
<td>167,000</td>
<td>170,000</td>
</tr>
</tbody>
</table>

Source: Large and Mid-sized Operators.

10.23 We made adjustments to some Large Operators’ MEA figures as a result of our review. These are discussed in more detail in the respective individual operator annexes in Appendix 10.3.

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\(^{14}\) Operators generally used the cost data for the financial year 2008/09.

\(^{15}\) The bus purchase costs for an operator’s chosen base year was adjusted for each of the other years in the period. This adjustment was carried out to account for any changes in bus purchase costs year on year and as such to ensure that the choice of base cost year did not materially affect the MEA results. This adjustment resulted in holding gains or losses in each period being the gain or loss the operator incurred resulting from holding the bus from one year to the next. This was credited/charged to the operator’s operating profit.

\(^{16}\) The data was not provided on a perfectly comparable basis across all operators due to differences in general bus specification and the inclusion or exclusion of items such as CCTV. We considered, however, that the data was sufficiently robust as a result of the number of operators who responded and the breadth of vehicles and years covered to allow us to assess the reasonableness of bus fleet MEA adjustments. [\(\ldots\)]
Operators proposed different approaches to the valuation of land and buildings, depending on the date on which a valuation had last been performed and their view of industrial property and land values over the period. We noted, however, that land and buildings generally made up around a quarter of operators’ fixed asset base on both a book and MEA value basis, irrespective of the approach adopted. These approaches are discussed in more detail in Appendix 10.3.

We assessed each approach on its individual merits. We looked in particular at the dates for the most recent valuations (if these were used as a base for MEA value) and the specific indices adopted by the operators. We were not able to benchmark the average cost of depots (representing the largest element of properties held) in the same manner as buses as these were not homogenous across individual operators or between operators. We were satisfied, however, that the valuations and indices adopted were reasonable although we took the variations in indices into account in our interpretation of the results.17

Some operators revalued other asset classes in addition to buses and land and buildings. These assets represented less than 5 per cent of book or MEA value. We included these revaluations in our calculations of MEA ROCE.18

We adopted the principle that only costs incurred by operators which created an asset should be considered for capitalization as an intangible asset and included within ROCE. To be capitalized, these costs needed to: comprise a cost incurred now, primarily to obtain earnings in the future; be additional to those necessarily incurred at the time in running the business; be identifiable as creating an asset separate from any that arises from the general running of the business; and be measurable.

With these principles in mind, we capitalized training costs for new drivers and the costs of apprenticeships for engineers and craftsmen. We did not capitalize training costs for existing staff because we considered that ongoing training constituted part of any bus operator’s necessary expenditure to run its business. As such, it was revenue rather than capital expenditure. We did not capitalize any other material cost categories.

We excluded goodwill from our ROCE calculation on the grounds that it did not meet the criteria outlined above; in particular, it did not represent a separately identifiable intangible asset that could be isolated from the business as a whole.

The approach we adopted for the treatment of intangibles and goodwill was in line with previous CC market investigations. The general principles of this approach were set out in the CC’s investigation into the supply of banking services by clearing banks.

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17 The treatment of land and building MEA valuations was the same as for buses with changes in net book value recognized in the operators’ asset bases and the change in depreciation plus any holding gain or loss associated with the MEA valuation methodology reflected in the operators’ profit and loss account.
18 We did not consider that the effect of including or excluding them from the MEA valuation exercise would lead to a material difference in the individual operator’s ROCE calculations.
to small and medium-sized enterprises and reviewed by Sir Bryan Carsberg on behalf of the Treasury. A detailed description of our approach and operator comments in relation to intangible assets and goodwill is in Appendix 10.1.

Pensions

10.31 We received a mixed response from operators in relation to what should be included within pension costs in our analysis. Arriva, National Express and Stagecoach argued that deficit repair payments should be included in our profitability calculation, whereas FirstGroup and Go-Ahead believed they should not.

10.32 In approaching this issue, we considered that in this case the relevant levels of costs were those that would be faced by a new entrant. We considered that the relevant costs should include only current service costs as stated in the statutory accounts, ie excluding credits and charges relating to surplus or deficit funding, past pension service, interest payments and expected returns on a plan’s assets. We considered in this case that a new entrant would not view pension deficit repair payments as a relevant cost when assessing whether to enter the market or not, since it would not have a legacy pension scheme on which a deficit had accrued. This approach is consistent with our valuation of capital employed, which we have assessed on an MEA basis (see paragraph 10.17). A detailed description of our approach in relation to pensions is in Appendix 10.1.

Our assessment of the robustness of our profitability estimates

10.33 In drawing conclusions from our results, we recognize that there is inevitably an element of uncertainty surrounding the measurement of profitability. This differs from case to case according to the quality of the data available and the nature of the industry itself.

10.34 Asset valuation is typically one of the most significant problems faced in estimating ROCE. In certain sectors, such as those characterized by rapid technological change, it may be difficult to obtain a robust estimate of MEA values. Similarly difficulties may occur in sectors with low levels of physical assets and high intangibles. Local bus services do not fall into either of these categories; they are not characterized by rapid technological change; they have a significant physical asset base principally in the form of buses and depots; and they do not have a high level of intangible assets.

10.35 Large Operators were able to supply us with current values for their bus fleets. Given the relatively homogenous nature of buses, we were able to benchmark the values in

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19 The supply of banking services by clearing banks to small and medium-sized enterprises: a report on the supply of banking services by clearing banks to small and medium-sized enterprises within the UK, by the Competition Commission, March 2002 (‘report into SME banking’).
21 Ongoing (or current) service costs refer to the cost of pension benefits earned by employees for service in the reporting period. They have no historic element and can be thought of as the pension costs that would be incurred by a brand new company with only the current employees. Under IAS19, the current service cost is an estimate calculated using actuarial assumptions, for example the discount rate at which future benefits are discounted to arrive at their present value. This may be higher, or lower, than the cash which is paid into the fund in respect of current service costs by the company. Ongoing service costs are reported within operating profit. (IAS19 is the international accounting standard which sets out rules governing the treatment of employee benefits, including pensions, in a company’s financial statements. IAS 19 has been mandatory for UK listed companies since 2005.)
22 Deficit repair payments are the amounts, agreed with the pension scheme trustees, which a company is required to pay over time to eliminate a pension fund deficit. They do not affect operating profit.
order to obtain additional confidence that they were reliable. Large Operators were also able to provide us with their view of current value of their depots based on the most recently available valuations together with information about subsequent movements in land and property values derived from indices. Whilst there was an element of subjectivity in these valuations and some variation in methodology adopted by the operators, we were satisfied that they were calculated on a reasonable basis.\footnote{We note that some uncertainty still arises from the assumptions used to value intangible assets and the MEA value of other tangible fixed assets. However, these assets form only a small proportion of the capital base and therefore do not materially affect the profitability calculation.}

10.36 For the reasons set out above, we are confident in our estimates of MEA values and consequently our estimates for the plausible range of operator profitability.

Third party profitability analysis

10.37 In the course of our investigation, two third parties provided us with their own analysis of the profitability of local bus services: ‘Review of bus profitability in England’ (July 2010) by LEK, commissioned by the DfT,\footnote{www.dft.gov.uk/pgr/regional/buses/profitability.} and ‘The economics of bus operation and the prices people pay’ (2009) by TAS. LEK looked at the returns for the Large Operators’ subsidiaries and some Mid-Sized Operators in England using principally statutory accounts data. TAS used a theoretical regulatory model to estimate the required return for a bus operator in three operating areas.

10.38 We considered that there were limitations in both the data used and the approaches adopted by both parties. Given the limitations, we have not placed significant weight on the results obtained by either party. Since our analysis was based on detailed management account data which had been adjusted to reflect, for example, MEA values, it provided, in our view, more robust figures from which to assess the industry’s profitability. Further details of the work of LEK and TAS are in Appendix 10.1.

Cost of capital

10.39 As discussed in paragraph 10.4 we do not always seek to assess the actual level of profitability of the firms currently in the market. We may make adjustments to actual profits to reflect the level of profitability that may be earned by a hypothetical efficient stand-alone operator. This concept applies equally to the weighted average cost of capital (WACC). Individual company WACC estimates may be influenced by company-specific factors. As such, we looked to estimate a WACC that represents the costs faced by an efficient operator in a competitive environment; this is not necessarily the same WACC faced by individual operators.

10.40 We estimated our WACC using a wide array of data rather than a narrow focus on operators’ individual costs of capital. In arriving at our estimate, we assumed that the overall risk profile of one large local bus operator should not be materially different from that of another large local bus operator. Whilst we expect there to be some local variation, all local bus businesses are exposed to systematic risks to broadly the same extent. In addition, we expect the financing costs and the ability to raise funds to be similar across all operators given an equivalent risk profile and size.
10.41 We estimated a nominal pre-tax WACC\textsuperscript{25} for the UK local bus industry for the period 2005/06 to 2009/10 of between 8.5 and 10.9 per cent with a mid-point of 9.7 per cent (see Table 10.2). A detailed description of the WACC calculation is in Appendix 10.2.

### TABLE 10.2 CC estimate of UK local bus nominal pre-tax WACC

<table>
<thead>
<tr>
<th>Cost of equity (Ke)</th>
<th>Low</th>
<th>High</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-free rate</td>
<td>4.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Equity risk premium</td>
<td>4.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Equity beta</td>
<td>0.8</td>
<td>1.0</td>
</tr>
<tr>
<td>Post-tax Ke</td>
<td>7.2</td>
<td>10.0</td>
</tr>
<tr>
<td>Pre-tax Ke</td>
<td>10.1</td>
<td>14.1</td>
</tr>
<tr>
<td>Cost of debt (Kd)</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Gearing</td>
<td>40.0</td>
<td>40.0</td>
</tr>
<tr>
<td>Tax rate</td>
<td>29.0</td>
<td>29.0</td>
</tr>
<tr>
<td>Pre-tax WACC</td>
<td>8.5</td>
<td>10.9</td>
</tr>
<tr>
<td>Midpoint</td>
<td></td>
<td>9.7</td>
</tr>
</tbody>
</table>

Source: CC calculation.

10.42 We consider the above range to be a reasonable estimate of the cost of capital that would have been faced by a hypothetical stand-alone local bus operator. In our assessment of two components in particular, we believe we have been conservative. First, in relation to gearing, our estimate of 40 per cent is towards the lower end of the likely range; if we assumed a higher level of gearing, the WACC range would be lower. Second, our estimate for the cost of debt of 6.0 per cent is at the upper end of the likely range for the cost of debt of 5.0 to 6.0 per cent. In our decision to adopt a range for the beta, rather than a point estimate, we have taken into account the uncertainty associated with this parameter. Overall we consider the results when combined with our range estimates for other parameters (equity risk premium, risk-free rate and cost of debt) to be plausible and not overly conservative.

### Results of national profitability assessment

10.43 The results of our analysis of ROCE for the Large Operators are set out in Table 10.3 (see also Figure 10.1).\textsuperscript{26} It shows that the overall average ROCE for the five-year period of 13.5 per cent was 3.8 percentage points above the mid-point of our cost of capital range (2.6 percentage points above the top). The period average ROCEs for each of the Large Operators were above the top of our cost of capital range of 10.9 with a range of [\(\times\)] to [\(\times\)] per cent. In addition, the annual average ROCEs were at or above the top of our cost of capital range throughout the period with returns being higher at the end of the period than the start. In 2005/06, average returns for the large operators were 10.9 per cent (at the top of our cost of capital range). Over the next three years, returns increased so that in 2008/09 the return was 16.2 per cent. In 2009/10, the returns for three out of the five Large Operators decreased, resulting

\textsuperscript{25} Historic ROCE is based on the accounting data of the operators which has not been adjusted for the effects of inflation, ie it is stated on a nominal basis. Pre-tax WACC is used to remove any differences between operators resulting from their tax position, eg group relief of losses brought forward.

\textsuperscript{26} Large Operators have different financial year ends: Arriva—31 December, FirstGroup—31 March, Go-Ahead—52 weeks ending June/July, National Express—31 December and Stagecoach—30 April. For the purpose of our analysis, we have grouped the different reporting year ends into financial years, eg financial year 2005/06 covers reporting years ending December 2005 to June/July 2006.
in the average for that year declining to 14.0 per cent; although excluding \[\times\], the average return declined only marginally to \([\times]\) per cent.

**TABLE 10.3** CC's calculation of the Large Operators’ annual ROCE (MEA) **per cent**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Arriva</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
</tr>
<tr>
<td>FirstGroup</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
</tr>
<tr>
<td>Go-Ahead</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
</tr>
<tr>
<td>National Express</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
</tr>
<tr>
<td>Stagecoach</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
<td>[×]</td>
</tr>
<tr>
<td>Average</td>
<td>10.9</td>
<td>13.2</td>
<td>13.0</td>
<td>16.2</td>
<td>14.0</td>
<td>13.5</td>
</tr>
<tr>
<td>CC cost of capital range</td>
<td>8.5 – 10.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CC cost of capital mid-point</td>
<td>9.7</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** CC calculation.

10.44 Figure 10.1 shows the Large Operators’ annual ROCE by operator. It shows that whilst all Large Operators have an average ROCE above the cost of capital and there was an upwards trend in annual average ROCE, individually they have distinct patterns of profitability: \([\times]\).

10.45 Figure 10.1 also shows that almost all (22 out of 25) of the annual returns were above our mid-point estimate for the cost of capital range and 19 of these were above the top of the range. Some returns were substantially above the top of the range: 11 out of 25 observations were more than three percentage points above with eight exceeding four percentage points. Three operators earned returns that were within the cost of capital range in the early part of the period, and there was one instance of an operator’s annual return being below the bottom of the cost of capital range.
To understand the reasons for the fluctuations in returns by operator, we also looked at operating margins over the period. Figure 10.2 sets out the annual operating margins for the Large Operators. It shows a similar pattern over the period to that of the annual ROCE.

Source: CC calculation.

Operating margins have been calculated using the figures shown in Table 10.3 (operators MEA ROCE).
10.47 We looked at each of the Large Operators’ returns to understand the key factors affecting financial performance. We examined in particular factors affecting cost and capital employed. We found that generally the operators had reduced costs as a proportion of revenue and in some cases in absolute terms through targeted programmes. We also noted that the different approaches to and the timing of fuel hedges had a sizeable effect on the level of return. In addition, movements in working capital balances had a significant effect on returns over the period. We have set out in each of the operator annexes to Appendix 10.3 detailed discussions of the relevant factors for each of the Large Operators.

10.48 We also note that the four Large Operators currently listed on the London Stock Exchange have not reported a decline in profitability in their local bus operations in the period since our analysis. On the contrary, as shown in Table 10.4, all reported an increase in annual operating margins for their UK bus operations\(^28\) compared with the financial year 2009/10.\(^29\) In addition, we note that figures provided to us by Arriva show that its operating profit for its UK bus region for the year ended December 2010 is in line with previous years (see Appendix 3.1).\(^30\) This indicates to us that the five-

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\(^28\) We note that in some cases these margins include London bus services which are outside the scope of our reference, and as such are not directly comparable with our analysis.

\(^29\) FirstGroup stated that its ‘operating profit increased by 19.4 per cent … due to lower hedged fuel costs, operating efficiencies and the actions [it] took to manage [its] network’ (Final results 12 months ended 31 March 2011). Go-Ahead stated that its ‘deregulated bus division performed well during the year, with strong growth achieved … Operating profit was significantly ahead of last year’ (Final results 12 months ended 2 July 2011). National Express stated that its UK bus operations ‘returned to industry average margin with operating profit up 36 per cent’ (Final results for the year ended 31 December 2010). Stagecoach’s 2011 annual report notes that operating profit was up 21.4 per cent (including the effect of a reduction in fuel costs) and operating margin was 17.1 per cent compared with 14.4 per cent in the previous year.

\(^30\) In Appendix 3.1, we set out summary revenue and operating profit figures provided by all the Large Operators from their management accounts for their UK local bus operations. These figures are unaudited and have not been adjusted in line with
year period reviewed for our profitability analysis is representative of both recent and current performance of the Large Operators.

**TABLE 10.4** Annual report UK bus operating margins

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>Percentage points</td>
</tr>
<tr>
<td>FirstGroup</td>
<td>10.6</td>
<td>13.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Go-Ahead</td>
<td>10.0</td>
<td>11.6</td>
<td>1.6</td>
</tr>
<tr>
<td>National Express</td>
<td>7.1</td>
<td>11.0</td>
<td>3.9</td>
</tr>
<tr>
<td>Stagecoach</td>
<td>14.4</td>
<td>17.1</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Source: Annual reports.

10.49 In our interpretation of the results, we looked to see if there were any external factors which could explain the level of operator returns. We noted that the statutory minimum aspect of the concessionary fare scheme was extended to free off-peak bus travel in England within local authority areas in 2006 and nationally in 2008. We also noted that during the period 2005/06 to 2009/10, the proportion of revenue derived by the Large Operators from concessionary fares rose significantly. However, we were not able to determine the effect of this revenue change on the operators’ overall profitability.

10.50 FirstGroup argued that the differences between profits and the cost of capital could be explained by efficiencies and innovation. It argued that the CC analysis in Appendix 9.7 showed that Large Operators were on average more efficient than Small or Mid-sized Operators, and that our analysis in Appendix 9.6 showed that Large Multi-Regional Operators achieved the lowest average (VC + SVC) and TC per km ratios with £1.20 and £1.47 per km respectively. Mid-Sized Operators generated the highest average cost per km ratios with £1.48 and £1.83 respectively; and Small Operators generated £1.36 and £1.58 respectively.

10.51 We carried out an econometric analysis of bus operator costs. In our view, the results in Appendix 9.6 cannot be used to infer relative efficiency between the Large Operators. The operator dummy variables we included were control variables and as such capture many factors affecting costs that are specific to individual operators. These may include efficiency but may also reflect other factors, such as the influence of the geographic make-up of operators’ respective services. An inefficient operator that happens to be present in many areas where the cost of supplying buses is low might therefore display a lower value than a more efficient operator that operates in higher-cost areas. We also note that the ranking of operators by cost in Appendix 9.6 does not mirror the ranking of operators by profit (see Figures 10.1 and 10.2).

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our approach as set out in this Section and so are not directly comparable. The figures show for some operators a different pattern from that reported in their annual accounts. However, these differences are not significant enough to change our overall view that the five-year period reviewed for our profitability analysis is representative of both recent and current performance of the Large Operators.

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31 The statutory minimum concession for off-peak travel was introduced in Scotland in 2002 and extended to peak travel in 2006. Wales has a similar concessionary minimum standard.

32 The proportion rose from 12 per cent of revenue in 2005/06 to 23 per cent in 2008/09 and 21 per cent in 2009/10. In absolute terms it was 126 per cent higher in 2008/09 compared with 2005/06 (and 119 per cent in 2009/10), whereas fare revenue compared with 2005/06 grew by 5 per cent to 2008/09 and 13 per cent to 2009/10.

33 We note that the concessionary fare scheme is intended to reimburse operators for lost revenue and additional cost incurred in operating the scheme and put them in a ‘no better, no worse’ financial position.

34 FirstGroup response to provisional findings, paragraph 5.5(c) and Appendix 1, paragraph 1.10 9b).

35 Appendix 9.7, paragraph 43, ‘Large Multi-Regional Operators achieved the lowest average (VC + SVC) and TC per km ratios with £1.20 and £1.47 per km respectively. Mid-Sized Operators generated the highest average cost per km ratios with £1.48 and £1.83 respectively; and Small Operators generated £1.36 and £1.58 respectively’.

36 Response to provisional findings, paragraph 1.5 and letter of 12 December 2011.
Similarly our analysis in Appendix 9.7 simply states that Large Operators achieved a lower average cost per km than Mid-Sized and Small Operators. Our analysis does not assess whether these cost differences are a consequence of the efficiency of operators or other factors.

10.52 Notwithstanding the above, we saw nothing to suggest from the econometric analysis or the cost benchmarking study that any one operator or group of operators was more efficient than another. Further, the levels of average profitability in Table 10.3 did not indicate systematic differences in relative efficiency because all five large operators were found to have average levels of profitability in excess of the cost of capital and falling within a relatively narrow range.\(^{37}\) The claims of superior efficiency that were put forward by certain parties did not appear to be reflected in the pattern of profitability that we observed. It cannot be the case that each of the five Large Operators are all more efficient than average because they collectively represent over 70 per cent of the market.

10.53 With regard to innovation, we did not see evidence that any one operator or group of operators had earned profits in excess of the cost of capital as a result of continuous successful innovations. The example given by FirstGroup, of opening new routes or adding new services to routes, did not appear to us to be ‘innovative’; rather it was what one might expect an efficient operator to be doing as a matter of course. FirstGroup provided no evidence that it had developed a superior approach to the appraisal of new route or service opportunities and neither was this apparent from its relative profitability when compared with the other Large Operators.

**Mid-Sized Operator profitability**

**Methodology**

10.54 We also looked to see if there was evidence of any systematic difference in returns between the Large and the Mid-Sized Operators. For this analysis we used EBIT and EBITDA\(^ {38}\) and compared the average profit levels for the respective sizes of operators. We consider that this approach is reasonable in this context as we were looking at relative differences in profits rather than the absolute level of returns. The use of average returns meant that the effect of differences in capital structure on individual returns was reduced in significance. We also considered that the significant additional resources required by Mid-Sized Operators to produce suitable data for an MEA ROCE-based comparison would not produce substantially more robust results and as such could not be justified.

10.55 We did not look at the returns of Small Operators due to a lack of publicly-available data.\(^ {39}\)

10.56 Operating cost data for the Large Operators was taken from their responses for the ROCE analysis excluding any adjustments made for intangible assets capitalized. Mid-Sized Operator cost data was taken from their statutory accounts adjusted to be comparable with Large Operator data. See Appendix 10.3, Annex F, for details of the calculation and the individual operator returns.

\(^{37}\) Indeed, our conclusions on profitability (see paragraphs 10.86–10.90) are based on our analysis of the profitability of the Large Operators collectively.

\(^{38}\) EBITDA was included in our analysis to account for any differences in capital base and depreciation policies.

\(^{39}\) Companies which meet two of the following criteria—annual turnover below £5.6 million, a balance sheet total below £2.8 million and 50 employees or less—are allowed to publish abbreviated accounts. These accounts do not have to include sufficient detail to allow a comparison with Mid-Sized or Large Operators at the statutory account level.
Results

10.57 Table 10.5 sets out the average EBIT and EBITDA margins for Large and Mid-Sized Operators over the period. It shows that on average, Mid-Sized Operators have lower margins than Large Operators. However, these results need to be interpreted in the context of the small number of both Large and Mid-Sized Operators.\(^{40}\) Hence we have not attached significant weight to this finding.

**TABLE 10.5 Average EBIT and EBITDA comparison, Large and Mid-Sized Operators**

<table>
<thead>
<tr>
<th></th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
<th>2009/10</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EBIT</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td>8.8</td>
<td>9.4</td>
<td>10.0</td>
<td>10.8</td>
<td>9.5</td>
<td>9.7</td>
</tr>
<tr>
<td>Mid-Sized</td>
<td>4.6</td>
<td>6.0</td>
<td>6.9</td>
<td>5.9</td>
<td>6.6</td>
<td>6.0</td>
</tr>
<tr>
<td><strong>EBITDA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large</td>
<td>15.6</td>
<td>16.1</td>
<td>16.9</td>
<td>17.4</td>
<td>16.3</td>
<td>16.5</td>
</tr>
<tr>
<td>Mid-Sized</td>
<td>12.0</td>
<td>13.4</td>
<td>14.3</td>
<td>12.9</td>
<td>14.0</td>
<td>13.3</td>
</tr>
</tbody>
</table>

Source: CC calculation, statutory accounts.

Local profitability

Introduction

10.58 Our national level analysis looked at returns of the Large Operators at a national level. In this section, we look at profitability at the local area level. We chose depots as an appropriate proxy for local areas (see Appendix 10.4). Our analysis draws on a database comprising depot-level data from 37 Large, Mid-sized and Small Operators.\(^{41}\) Our local profitability analysis was designed to consider whether there were variations in profitability between areas and if so, what the reasons for those variations might be.

Methodology

10.59 We undertook two analyses to assess local profitability:

(a) Local depot profitability factors. We calculated an average profitability at a depot level for all depots within our data set to identify those depots with higher-than-average profit levels. We then chose the ten depots with the highest profits for each of four Large Multi-Regional Operators\(^{42}\) and asked them for explanations or the level of profits at each of these ten depots.\(^{43}\)

(b) Depot profitability and concentration. We performed a simple regression analysis to see if there was any correlation between depot profitability (based on the gross

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\(^{40}\) In total, there were five Large Operators and ten Mid-Sized Operators (including five Municipal). Of the Mid-Sized Operators, one made losses throughout the period and one operator was only included for two years in the period as prior to these years its operations mainly consisted of non-local bus services.

\(^{41}\) Our data set comprised data for the depots of the four Large Multi-Regional Operators (ie Arriva, FirstGroup, Go-Ahead and Stagecoach); National Express; the depots of eight Mid-Sized Operators; and whole-company data for 24 Small Operators. The four Large Multi-Regional Operators’ depots made up around 80 per cent of the total number of depots in the data set. This data was produced by the operators in accordance with CC-defined cost categorizations (see Appendix 9.7, Annex B).

\(^{42}\) National Express was not included due to its small number of depots and because most of its depots are clustered in one area (West Midlands).

\(^{43}\) We asked an open-ended question (ie there were no categories to choose from) and operators were not restricted in the number of explanations they could give for each depot.
margin less semi-variable costs (‘SV margin’)\(^{44}\) and concentration in the supply of bus services in that local area.

10.60 We also considered the extent to which operators had analysed links between depot profitability and concentration. Our review of operators’ internal documents did not indicate that this type of analysis was widespread. However, we noted that one operator, [X], had performed an exercise of this nature, which we discuss in further detail in paragraphs 10.78 to 10.84 below.

**Local depot profitability factors**

- **Profitability measure**

10.61 As set out in paragraph 10.11, our chosen measure for profitability at the national level was ROCE. However, the Large Operators do not produce detailed balance sheets at a local level which would have enabled us to calculate ROCE at the depot level. We considered that, on balance, SV margin was the most appropriate and practical measure to approximate depot profitability. We used the average of the last three years’ SV margin for each depot in our analysis, rather than each individual year,\(^{45}\) to reduce the effect of one-off factors and events on the results. Higher-than-average margins over the period are therefore more likely to be linked to underlying factors, impacting profitability at the depot level. A detailed description of our consideration of profitability measures is in Appendix 10.4.

**Results**

10.62 Figure 10.3 shows the distribution of SV margins across all the depots in the data set. It shows a wide distribution in margins ranging from around –37 to +50 per cent, with an average of 24 per cent.

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\(^{44}\) SV margin includes both direct costs (ie drivers’ payroll, net fuel and tyre costs), which make up the majority of depot operational costs, as well as significant other costs of running a local bus operation, such as vehicle depreciation, maintenance, insurance and licensing costs.

\(^{45}\) Operators provided us with up to three years’ worth of data at depot level (the ‘data set’) that enabled us to calculate the SV margins for around 300 depots.
10.63 We asked the Large Multi-Regional Operators for their explanations for the level of profits at their ten highest margin depots. We grouped their responses into five broad categories. These are set out in Table 10.6.

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market demand</td>
<td>Favourable demographics, market growth due to either population changes or specific initiatives to increase bus patronage and seasonality</td>
</tr>
<tr>
<td>Operational efficiencies</td>
<td>Efficient running of depots, high load factors, low labour and other input costs, use of fully depreciated buses, benefits from ticketing initiatives, inter-urban bus networks or benefits from links with other depots, and relatively large overheads requiring high SV margins to cover them</td>
</tr>
<tr>
<td>Government or local</td>
<td>Good relationships with local authorities covering commercial and tendered services and other support to increase bus patronage, government programmes, and increases in concessionary fares reimbursement rates</td>
</tr>
<tr>
<td>authorities</td>
<td></td>
</tr>
<tr>
<td>Fleet investment</td>
<td>Higher capital employed requiring higher margins to cover capital costs, but also leading to some increased patronage and lower engineering costs</td>
</tr>
<tr>
<td>Depot-specific factors</td>
<td>For example, low insurance claims, high non-bus revenues</td>
</tr>
</tbody>
</table>

Source: CC grouping based on responses from Large Multi-Regional Operators.
The top five reasons given by the operators for the high level of a depot’s profitability are summarized in Table 10.7. Details of the responses provided by the operators for all depots in the sample are in Appendix 10.4.

### Table 10.7: Top five reasons provided for high margins

<table>
<thead>
<tr>
<th>Reason given</th>
<th>Category</th>
<th>Number of depots*</th>
<th>% of answers†</th>
<th>% of depots</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depot efficiency/utilization</td>
<td>Operational efficiencies</td>
<td>15</td>
<td>11</td>
<td>38</td>
</tr>
<tr>
<td>Favourable demographics</td>
<td>Market demand</td>
<td>15</td>
<td>11</td>
<td>38</td>
</tr>
<tr>
<td>Market growth (company driven)</td>
<td>Operational efficiencies</td>
<td>12</td>
<td>9</td>
<td>30</td>
</tr>
<tr>
<td>Low input costs</td>
<td>Operational efficiencies</td>
<td>11</td>
<td>8</td>
<td>28</td>
</tr>
<tr>
<td>Use of newer buses</td>
<td>New buses</td>
<td>11</td>
<td>8</td>
<td>28</td>
</tr>
</tbody>
</table>

Source: Large Multi-Regional Operators.

*Total number of depots was 40.
†Operators were able to give multiple reasons for the level of profitability. The percentage represents the number of the times the reason was given for the margin over the total number of answers given (132).

10.65 High SV margins for a depot may indicate a lack of effective competition in the supply of bus services in the local area associated with that depot. However, there may be other reasons for higher depot profits. We analysed the operators’ responses to our question to assess whether the stated reasons for higher-than-average profitability were consistent with a competitive market.

10.66 In our view, high SV margins resulting from superior depot efficiency (eg as a result of specific depot initiatives) need not be indicative of competition problems in the short term, although over time we would expect to see these efficiencies replicated by other depots and eventually passed through to consumers in the form of lower fares or more frequent/better services. Similarly, we would expect to see high SV margins resulting from higher load factors which are not due to company-specific initiatives competed away over time either leading to lower fares or more frequent/better services. Similarly favourable depot locations and links to other depots would only be expected to lead to higher SV margins if they represent a barrier to entry and were therefore not available to other operators.

10.67 We would expect demand factors associated with market demand, Government and local authorities to apply the market as a whole. As such, high SV margins would be competed away over time. Persistently high margins would therefore suggest a lack of competitive interaction in the market. The one exception to this is the national concessionary fares scheme which may temporarily cause high or low margins irrespective of the competitive environment, depending on the level of reimbursement by local authorities.

10.68 The effect on margins of the age of buses used was unclear due to the interplay of depreciation, maintenance/running costs and passenger response to the age of buses used. Operators told us that newer buses tended to increase passenger numbers and had lower engineering costs which resulted in higher margins. These higher margins were partially offset by higher depreciation charges. However, we were also told that using older buses led to higher margins as the increase in main-

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47 Company-specific initiatives could be, for example, a more attractive service offering or promotions.
48 Although not stated by the operators as a reason for the high SV margins, a number of the depots in the sample were located close to other depots with high margins, which were in many cases linked to each other.
49 We concluded in paragraph 9.173 that the ease of accessing depots varies substantially across the reference area.
50 Higher SV margins due to higher demand should attract additional market entry either increasing the quantity/quality of the offering (eg higher frequencies reducing load factors) or driving down prices.
tenance costs was not always equivalent to the reduction in depreciation charge. Examples in relation to individual depots are set out in Appendix 10.4.

10.69 FirstGroup argued that factors such as favourable demand and demographic conditions and more efficient depot cost structures were entirely consistent with a competitive outcome for customers in markets where operators were constrained by the threat of potential competition. It said that operators in concentrated markets who were constrained by potential competition would provide a competitive offering\(^{51}\) so that no ‘gaps’ were set for rivals to exploit. However, this did not necessarily mean that SV margins or ROCE would be equalized across all depots.\(^{52}\) It argued that there was no reason to suppose that effective competition, ie competition that drove ROCE to a competitive level, would lead to equal SV margins across all depots, since competitors who engaged in effective operational management would enjoy a higher SV margin (and ROCE) than their competitors, and because greater investment could provide an advantage which generated higher SV margins, but which did not imply above-average ROCE.

10.70 Abramovich argued that the existence of high margins at some depots compared with others was not indicative of consumer harm, unless passengers experienced higher fares and lower quality of service (among other factors) than in areas where depots’ margins were low. FirstGroup considered that none of the explanations for high SV margins related to a deterioration in customer-facing aspects of the service. Both FirstGroup and Abramovich argued that their routes in areas where depots had high SV margins typically did not have materially different fares from routes in areas nearby where depots had lower SV margins.

10.71 The wide range and number of answers provided by the operators suggested that factors affecting depot margins were complex. We found that some of the reasons cited by operators for the higher-than-average profitability levels generated by these depots were inconsistent with a competitive market.

**Depot profitability and concentration**

**Methodology**

10.72 Our data set for this analysis covered the depots of the Large Operators. This corresponded to around 80 per cent of all depots in the data set. We used as the relevant concentration measure the proportion of all routes, weighted by service frequency, within 12 km of the depot serviced by an operator. This measure was designed to account for the share of an operator’s bus services within a viable operational range of a depot. We used a radius of 12 km as this approximates to the distance that a bus, at typical bus service road speeds, can travel within 30 minutes.\(^{53}\)

**Results**

10.73 Figure 10.4 shows the distribution of depot concentration. It shows a wide range in local concentration around depots.

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\(^{51}\) In terms of punctuality, reliability, fares, frequency and service quality.

\(^{52}\) FirstGroup argued that in a competitive market the marginal firm would make zero profits (ie sufficient profit for a return on capital employed). Firms that were more efficient or benefitted from more attractive demographics or demand conditions would make positive profits. It may not be possible to compete these profits away if they relate to market fundamentals which uniquely favour one firm or another.

\(^{53}\) See paragraph 7.107.
FIGURE 10.4

Distribution of depot concentration

Source: CC analysis.

10.74 Figure 10.5 shows the results of the regression of SV margin against concentration.

FIGURE 10.5

Correlation between SV margin and concentration

\[ y = 0.124x + 0.1701 \]
\[ R^2 = 0.136 \]

Source: CC analysis.
10.75 Figure 10.5 shows a statistically significant positive correlation between the level of concentration and the profitability of a depot. On average, depots used by operators which have a 10 per cent greater share of supply in the surrounding area than other operators in that area have SV margins that are around 1 per cent higher than those other operators. The analysis indicates that concentration ‘explains’ only a relatively small proportion of overall variability in depot margins.

10.76 Arriva argued that:

(a) our SV margin analysis was highly simplistic and did not control for other basic explanatory variables;

(b) the relationship between concentration and profitability was likely to be circular;

(c) the profitability measure used by the CC did not control for differences in capital employed by depots; and

(d) the SV margin did not control for differences in efficiency between depots. A simple analysis of depot SV margins averaged over a three-year period was therefore insufficient to draw any conclusion regarding the speed and extent to which increases in margin resulting from efficiency improvement were competed away by other operators.

10.77 Go-Ahead also argued that profitability of depots would be dependent on a large number of local factors, including fleet age, staff costs, land rental prices and the allocation of costs between depots. Not taking these factors into account could lead to an apparent but coincidental relationship between profitability and prices.

10.78 We acknowledge that our analysis was not as detailed and sophisticated as our PCA work (see Appendix 7.1). In particular, the simple regression does not control for factors that may drive depot profitability, including local variations in costs and demand conditions, as well as factors specific to particular operators or regions which may affect depot profitability. Our analysis does not establish a causal link between concentration and profit margin. The positive relationship between depot margins and local market concentration that we identify is, however, consistent with concentration being one factor which explains high returns in certain depots.

Operator analysis of depot profitability and concentration

10.79 We noted a presentation made to the divisional board of one large operator, in September 2009. This was described as a ‘review and analysis of Revenue per mile, Costs per mile and cost as % of revenue in order to develop a “Model” or “Framework” to better monitor the UK bus business going forward’. The analysis categorized areas into four types: Large City; City/Large Towns; Urban & Other; and Rural and Other, based on population, population density and other demographic factors. A detailed description of the analysis shown in the presentation and the key metrics used is in Appendix 10.4.

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54 The correlation between SV margin and concentration is significantly different from zero. The 95 per cent confidence interval for the slope of the regression is 0.086–0.162.
55 $R^2$ is 13.6 per cent.
56 Response to provisional findings, Section B2, paragraph 12.
57 Response to provisional findings, paragraph 7.3.2.
58 [X]
59 Paragraphs 17 & 18.
The presentation states that in large cities there is a strong correlation between revenue per mile (RPM), revenue per vehicle, the level of competition and EBIT margin. One aspect of this correlation is shown in Figure 10.6, which plots EBIT margins against the competition ratio.

**FIGURE 10.6**

Relationship between EBIT margin and competition ratio

![Graph showing the relationship between EBIT margin and competition ratio](image)

Source: CC calculation based on [X] data.

This correlation is also present across other area categorizations in the presentation (city/large towns, urban and other, and rural and other). This is shown in Figure 10.7.

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60 Examples of the correlation described in the presentation include: ‘[X] has strong RPM and revenue per bus and a low competitive base … but profitability is held back by its high cost base’ (slide 6, Large cities); ‘In low competition, 8 out of the 13 cities/large towns achieve the benchmark [X]% margin. In medium competition, only 3 of the 13 … achieve the benchmark [X]% margin and in High only [X]% achieves the benchmark’ (slide 8, Other cities and large towns); and ‘The 3 lowest margin areas have low revenue per bus, low RPM and relatively high competition’ (slide 9, Other urban areas).
We note that the presentation sets out a number of other reasons why margins are at the levels they are for each operating company which are not taken account of in the above correlations. These include a depot’s cost base being affected by various factors, in particular labour rates and fuel costs, the cost of traffic and the effect of FTR on revenue.

[\textit{\textsuperscript{\textcopyright}}] told us that the analysis was unsophisticated and was not intended to understand the relationship between depot performance and local competition. It said that the analysis had not been repeated.

[\textit{\textcopyright}] told us that the correlation did not control for any other factors that affected EBIT margins, such as the level of investment, the effectiveness of local management, local labour arrangements, favourable demand and cost conditions, and an efficient combination of local and non-local bus provision from the same depot. It said that it had found many cases where areas assessed as having high levels of competition had higher margins than areas which had lower levels of competition, so the usefulness of this metric—in the absence of any other controlling factor—was highly questionable.

Notwithstanding these comments, we find the analysis to be supportive of our own analysis set out in paragraphs 10.71 to 10.77 which shows a relationship between concentration and profitability.

**Conclusion on profitability**

Based on the analysis in paragraphs 10.43 to 10.84, our findings on profitability are as follows:

First, we find that overall Large Operators have earned profits persistently in excess of the cost of capital. We found that:

\begin{align*}
y &= -15.866x + 19.367 \\
R^2 &= 0.2394
\end{align*}
(a) The overall average ROCE for the five-year period of 13.5 per cent was 3.8 percentage points above the mid-point of our cost of capital range (2.6 percentage points above the top). The period average ROCEs for each of the Large Operators were above the top of our cost of capital range of 10.9. In addition, the annual average ROCEs were at or above the top of our cost of capital range throughout the period with returns being higher at the end of the period than the start (paragraph 10.44).

(b) Twenty-two out of 25 annual ROCEs for Large Operators were above the mid-point of the cost of capital range and 19 of these were above the top of the range with some of these returns being substantially above the top of the range. Returns were higher at the end of the period than the start, with only one instance of an operator’s annual return being below the bottom of the cost of capital range (paragraph 10.45).

(c) We were confident in our profitability estimates as we were able to obtain reliable MEA values for capital employed.

10.88 Second, using the average profitability of the Large Operators as a benchmark and the distribution of depot margins set out in Figure 10.5, we have found that some depots show high levels of profitability. Some of the explanations given for these levels of profitability are inconsistent with markets which work well (paragraphs 10.62 and 10.63).

10.89 Third, we have found a statistically significant positive correlation between depot margins and local market concentration, although this analysis has not established a causal relationship between the two (Figure 10.5).

10.90 Overall we conclude that operators representing a substantial part of the market have earned profits that were persistently above the cost of capital on a national basis. Moreover, we observe that profits have been high in some depots and note that there is a positive correlation between depot margins and local market concentration. We therefore conclude that competition may not have been wholly effective across the reference area and we have taken this into account when evaluating the evidence in the round on whether there is an AEC in the supply of local bus services.
11. Competitive analysis of the supply of local bus services

Introduction

11.1 In this section, we consider whether there are any aspects of the markets for the supply of local bus services which prevent, restrict or distort competition in the reference area. Local bus services include both commercial and supported services, although since supported services are those which would not be offered commercially, competition would not be expected to arise in the provision of these services other than where there is a coincidental overlap with other services.¹

11.2 This section is structured as follows:

- we set out the competitive constraints on local bus operators, including the different ways in which competition can occur between them, (see paragraphs 11.3 to 11.5);
- we discuss the evidence suggesting that competition between local bus operators is not effective, (see paragraphs 11.6 to 11.18);
- we consider whether the operation of local bus services is an example of competition 'for the market' rather than competition in the market, and if so, whether this provides an effective form of competition, (see paragraphs 11.19 to 11.22);
- we consider whether any other aspects act as constraints on operators’ behaviour, (see paragraphs 11.23 and 11.24);
- we summarize our findings on the effectiveness of competition (and hence that there is an AEC (see paragraphs 11.25 to 11.27));
- we identify the features that cause this AEC and how these features combine to cause the AEC (see paragraphs 11.28 to 11.52); and
- we consider the extent to which our findings vary locally and in particular we set out our findings at the level of individual routes and Urban Areas, (see paragraphs 11.53 to 11.86).

Competitive constraints on local bus operators

11.3 Constraints on local bus operators can arise from a number of different sources. This includes the threat that customers may switch to rival bus operators or to other transport modes to make their journey, or the prospect of entry or expansion by other local bus operators which currently do not provide competing bus services.

11.4 In our assessment of market definition, we found that in general the constraint from alternative methods of travel was relatively weak in both the short run and the long run, (see paragraphs 7.11 to 7.65). Notwithstanding this, for a relatively small number of flows, we found that competition from fixed modes of transport, such as rail or tram services, may provide an effective competitive constraint (see paragraphs 7.52 to 7.63).

¹ We discuss competition in the tendering of these services in Section 13.
We found that where bus operators compete with each other this provides a closer constraint than that provided by alternative transport modes. There are a number of ways in which local bus operators can compete with each other:

(a) Head-to-head competition, where operators provide services so that passengers have choice of operator to complete their journey. The effectiveness of head-to-head competition between operators will depend on the similarity of service provided by them, as this will determine the number of passengers who view them as substitutes (see paragraph 8.5).

(b) Potential competition, where an incumbent operator is constrained by the threat that bus operators with services and facilities in or near to the incumbent’s area of operation might redeploy or expand their existing services to compete head-to-head (see paragraph 8.104). The strength of constraint can be influenced by a number of factors including the characteristics of the potential entrant (and the incumbent), as set out in paragraph 8.133, barriers to entry and expansion (see paragraphs 9.210 to 9.226), and geographic market segregation (see paragraphs 8.258 to 8.262).

(c) New entry, where an incumbent operator is constrained by the prospect that an operator without existing services and facilities nearby may start competing head-to-head (see paragraph 8.104). The strength of this constraint will depend on barriers to entry, as set out in paragraphs 9.210 to 9.226.

Evidence that competition is not effective

In a well-functioning local bus market we would expect to observe effective competition in the form of one or more of the above sources to ensure that prices and other aspects of operators’ services are set at competitive levels. However, our assessment of the evidence, which is set out in full in the previous sections of this report, indicates that competition between local bus operators is not effective. We refer to this evidence in the following paragraphs under four headings:

(a) General indicators that competition is not effective;

(b) Head-to-head competition;

(c) Potential competition; and

(d) New entry.

General indicators that competition is not effective

The evidence on market outcomes shows that in many cases local bus operators are not effectively constrained. In particular, we have found that the extent of head-to-head competition between bus operators has an effect on market outcomes. This shows that other constraints are weakened or absent:

There may be a few exceptions where train or tram services offer an alternative for the same journey.

Various operators pointed to surveys of customer satisfaction which found high levels of satisfaction across the range of their operations, suggesting that the extent of head-to-head competition did not drive satisfaction. However, data was not available to us which would have allowed us to match satisfaction to whether particular respondents made journeys where there was head-to-head competition. We also note that the answers to such surveys can depend on whether customers have experience of bus services in a variety of other areas so that they can form comparative impressions, for example on how fares compare in answering whether they are reasonable. Rather than easily allowing comparisons between areas, such surveys more accurately reflect how satisfaction changes within an area over time.
(a) Evidence from our case studies, parties’ internal documents and questionnaires and submissions shows that operators have improved their offering where they face head-to-head competition (and in some cases potential competition), compared to where this was absent (paragraphs 6.49 to 6.72).

(b) Evidence of entry and expansion from our case studies, parties’ internal documents and questionnaires and submissions shows that entry by a potential competitor or new entrant in many cases has stimulated improvements in the incumbent’s offering (for example, see paragraphs 6.105 to 6.142). This evidence shows that, in these cases, the prospect of potential competition and new entry was insufficient to constrain the incumbent operators’ services to competitive levels.

(c) Our performance concentration analysis found at both route and Urban Area level that the extent of competition from other operators affected the frequency of bus services operated (see Appendix 7.1).4

(d) Our assessment of geographic market segregation (see paragraphs 8.166 to 8.262) indicates that sufficient barriers to entry and expansion exist that two operators (in the case identified) considered it possible and worthwhile to avoid competition in each other’s Core Territories.

11.8 Our analysis of profitability has found that operators representing a substantial part of the market have earned profits that were persistently above the cost of capital on a national basis—see paragraph 10.88. The results indicate that competition may not have been wholly effective across the reference area.

**Head-to-head competition**

11.9 Head-to-head competition can take place over the entire length of a route or over a section of it. Where operators’ services overlap sufficiently to provide an alternative for some passenger journeys, there will be some head-to-head competition between operators. However, the intensity of head-to-head competition between two operators will depend on the similarity of service provided by them, both in terms of the passenger flows they serve and in terms of the nature of the service that they offer, as this will determine the number of passengers who view them as substitutes.5

11.10 We found that, where head-to-head competition exists, it delivers significant benefits to customers (see paragraphs 8.7 and 8.8).

11.11 The pattern of service provision that we have seen shows that head-to-head competition for passengers is uncommon. The full results of our analysis are set out in Appendix 8.1. As reported at Appendix 8.1, Tables 1 and 2, we find that practically all routes in the reference area face some overlap from a rival operator. However, of these routes:

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4 A consistent pattern is also observed in the correlation between depot margins and local market concentration (see paragraph 10.90). The evidence in this analysis is consistent with local market competition impacting on local profitability, albeit that it does not establish a causal relationship between the two.

5 We consider that head-to-head competition is effective if it constrains the behaviour of a bus operator so that fares, frequencies and other aspects of its offer are at competitive levels. This occurs where a sufficiently large proportion of passengers would substitute to another operator in response to a reduction in the value of an operators’ competitive offer. This will depend on the proportion of passenger journeys occurring where overlaps apply, and whether customers are likely to switch (eg depending on whether rival services operate at similar times, with similar frequency, journey times and so on).
(a) 46.2 per cent, accounting for 63.4 per cent of all weekly services in the reference area, face such limited overlap that they do not face effective head-to-head competition;

(b) 2.5 per cent, accounting for 1.4 per cent of all weekly services in the reference area, face overlap from a rival operator’s route over all or nearly all their length, and so are likely to face effective head-to-head competition;

(c) 51.3 per cent, accounting for 35.2 per cent of all weekly services in the reference area, face an overlap that may or may not provide a substantial proportion of passengers a choice of operator. For these routes, a lack of flow-level information prevents us from drawing firm conclusions on the extent to which they face head-to-head competition. Nevertheless, the extent of overlap faced by these routes suggests that, at least in a substantial number of cases, a large proportion of passengers on these routes are unlikely to have a choice of operator.

11.12 We found that there were four aspects that together restrict the extent of head-to-head competition. These were: consumer behaviour (tendency to board the first bus to their destination that arrives at the bus stop unless purchased ticket in advance); within-route network and ticketing effects; transparency within the industry as to where services are operated; and the ease with which operators can target competitive activity (see paragraphs 8.41 to 8.60). In addition, we have found in the North-East of England that the extent of head-to-head competition was mitigated by operator conduct leading to geographic market segregation.

Potential competition

11.13 Our analysis of market structure found many local markets to be highly concentrated. For example, the average share of the largest operator of local bus services in all Urban Areas is 69 per cent (see paragraph 4.17). Even when we extend the Urban Area to include a 12 km ‘buffer’ around the area to reflect possible potential competition from operators outside the immediate area, we still find that in 41 per cent of Urban Areas, the largest operator controls 60 per cent or more of supply in both the Urban Area and wider area (see paragraph 8.125). These findings indicate that the extent of potential competition may be limited through a lack of suitable competitors being in close proximity.

11.14 Evidence on the extent of the constraint from potential competition is mixed. The qualitative evidence showed that in some cases incumbent operators took actions because of the threat of entry onto their routes from a nearby rival. However, there were instances where operators did not appear to take any account of the threat from nearby rivals. The constraint posed by the expansion of entry by Large and Mid-Sized Operators also appears to be stronger than that from the threat of expansion by Small Operators. We were unable to distinguish between head-to-head and potential competition in our Urban-Area-level performance concentration analysis. Our route-level analysis was designed to capture the effects of head-to-head competition; however, we extended our analysis and found no positive evidence that potential competition was a systematic constraint on incumbent operators. We also found that barriers to entry and expansion can restrict the constraint from potential competition (see paragraphs 11.41 to 11.43).

11.15 Further, geographic market segregation, where it applies, will serve to reduce or eliminate the constraint from potential competition. This is discussed in paragraphs 11.48 to 11.52.


**New entry**

11.16 If there were an effective constraint on existing operators from the threat of new entry, we would not expect to observe variation in local market behaviour and outcomes according to the degree of head-to-head competition. However, as noted in paragraph 11.7, we find that the extent of head-to-head competition in local markets leads to differences in market outcomes. This indicates that while the threat of entry may exert a constraint on operators and may influence their conduct, this is not a strong constraint.

11.17 As noted in paragraphs 6.74 and 6.75 and Appendix 6.5, the amount of entry that we observe is limited, although this is not of itself indicative of whether there are barriers to entry or whether competitive market outcomes mean that opportunities for entry are limited.

11.18 We find that the constraint from new entry is restricted by barriers to entry and expansion (see paragraphs 11.41 to 11.43). We have not seen evidence in operators’ internal papers suggesting that the threat of new entry is considered as a constraint (see paragraphs 8.148 and 8.149). The qualitative evidence shows greater consideration of potential competition than new entry. Further, new entry faces greater barriers than potential competition, in that it requires the establishment of a new operation.

**Competition for the market**

11.19 We considered whether competition in the operation of local bus services could be characterized as ‘effective competition for the market’; where operators compete periodically to be the operator which supplies a particular flow or route.

11.20 We concluded that the operation of local bus services was not an example of effective competition for the market for two reasons.

11.21 First, under the process of competition we have identified, it is not certain that the ‘winning’ operator is necessarily the one that is more efficient or that is best able to serve customers, because operators have differing ability to survive the process of competition. Larger operators have a greater ability to cross-subsidize from one part of their operation to another. This makes them better able to survive a period of intense competition with the result that a smaller but otherwise more efficient operator may not be able to displace a larger rival.

11.22 Second, we found that incumbent operators benefit from a number of barriers to entry. As a consequence, to displace an incumbent, a new entrant would need to be not only more efficient but sufficiently more efficient to overcome the barriers to entry. In addition, because of the barriers to entry, there may be little pressure on the ‘winning’ operator to maintain its competitive behaviour over time.

**Constraints in the absence of head-to-head competition**

11.23 As set out in paragraphs 11.13 to 11.18, the threat of potential competition and new entry will impose a relatively weak constraint on operators. This does not, however, mean that they will necessarily impose no constraint at all. In Appendix 11.1, we found that where head-to-head competition was absent, the behaviour of bus operators was constrained to some extent by a number of other factors, including potential competition and the prospect of new entry. Other factors included the need for operators to have regard to network effects when setting fares and other aspects
of their service; the threat of entry; and the need for operators to maintain good relations with the LTA and other stakeholders.

11.24 We were unable to isolate the impact of each of these constraints separately, but we were able to understand their collective strength. The evidence on market outcomes (see 11.7 and 11.8) shows that, collectively, these other constraints are not sufficient to prevent an AEC from arising altogether. However, they are sufficient to reduce the detrimental effect of the AECs on customers, relative to what we would expect to see absent these other constraints. In our assessment of the detrimental effect on customers we take these other constraints into account by basing our estimates of detriment on the effects that we observe in practice (see paragraphs 14.23 to 14.40).

Findings on the effectiveness of competition

11.25 In a well-functioning local bus market, we would expect competition (from rival bus operators and/or competing travel modes) to constrain the behaviour of local bus operators with the result that the prices and other aspects of their offer to customers are set at competitive levels. We have found that:

- Head-to-head competition, where it exists, is an effective constraint on the behaviour of local bus operators. However, we found that head-to-head competition is uncommon (see paragraphs 11.11).

- Potential competition can act as a constraint on incumbent operators’ behaviour (see paragraphs 8.161 to 8.165). However, this constraint is weaker than that provided by head-to-head competition because of the existence of barriers to expansion, some of which we have found to be pervasive (see paragraphs 9.210 to 9.226). Where potential competition does exist, the level of constraint is dependent on specific local circumstances, in particular the relative strength and identity of the potential competitor and the strength of the barriers to expansion that the potential competitor will face. Where an area is highly concentrated, potential competition will be weaker if there are few rivals to exert a constraint.

- The constraint from new entry is weaker still than potential competition, see paragraph 8.164. New entrants face further or larger barriers than in the case of potential competition (see paragraph 9.222).

11.26 Where competition is weakened so that operators are not forced to compete to attract customers, we expect that in many places market outcomes will result in a detriment to consumers. This detriment could arise because bus operators are able to reduce the quality of service they offer to customers (through shorter hours of operation and less frequent services, or otherwise lower quality or reliability of services), or increase fares above the level that would otherwise apply. Higher fares may also increase the costs of concessionary fare reimbursement. Bus operators may also be able to withdraw some less profitable services altogether in areas where they face little competition. Reduced competitive pressure may also result in reduced innovation in bus services and reduced pressure on operators to control costs and operate their businesses efficiently.6 Some direct evidence showing adverse outcomes is described at paragraph 11.7. Customers will also have less ability to

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6 Both aggressive responses to competition on a route and retaliation against entry occurring on other routes may in the short term bring benefits to consumers if some routes are competed more intensely. However, the point of strategic responses to entry and competition is that, if it is successful, head-to-head competition is diminished across multiple routes and markets and the likelihood of entry is reduced.

11.27 We therefore find that competition in the supply of local bus services is not effective in those local markets where head-to-head competition does not exist, and hence that there are adverse effects on competition (AECs). We now consider which features cause this prevention, restriction or distortion of competition.

**Identifying the features which cause AECs**

11.28 We have identified four features of local bus markets which mean that effective head-to-head competition is uncommon and which limit the effectiveness of potential competition and new entry:

(a) The first feature is the existence of a high level of concentration in each relevant market. This refers to the extent of overlap between operators’ services causing high concentration at the level of passenger flows. For an AEC to arise in a relevant market, effective head-to-head competition has to be absent. High concentration can also refer to the limited presence of operators across a wider local area, but this is not a necessary condition for the feature to arise. In such cases, this indicates that the constraint from potential competition will be reduced, adding to the impact of the AEC.

(b) The second feature is the existence of barriers to entry and expansion, which limit the constraint from potential competition and new entry and which maintain the high concentration in the market.

(c) The third feature is how customers conduct themselves in deciding which bus to catch. There are two aspects of customer conduct. First, some customers commit to a particular operator by purchasing a single-operator multi-journey ticket. Second, customers place a high value on time saved and certainty, relative to other factors such as price or quality. This means that customers who are not already committed to an operator prefer to catch the first available bus when at the bus stop and to minimize waiting time. As a result, operators have an incentive to compete in ways which are likely to create overcapacity and could lead to the exit of the entrant or incumbent. This serves to increase or maintain high concentration in the market and also discourages the likelihood of new entry.

(d) The fourth feature is operator conduct, by which operators avoid competing with other operators in Core Territories, leading to geographic market segregation. We have found that this conduct applies in relation to two operators in parts of the North-East of England. This reduces the extent of head-to-head competition between operators and reduces the constraint from potential competition and new entry.

11.29 We find that these features give rise to AECs in two ways.

11.30 The first way in which AECs arise derives from features (a) to (c). If a flow is highly concentrated, an operator will not face effective head-to-head competition against its services. In addition, the constraints from potential competition and new entry are restricted by the barriers to entry and expansion that we have identified. Potential competition may also be further weakened if the wider local market is highly concentrated. Customer conduct contributes to this outcome in that competition can take forms as described in paragraph 11.46. This creates or reinforces barriers to entry and expansion, and may be a cause of high concentration. In the absence of these market features, we would expect that local bus operators would compete such
that there was more head-to-head competition on a route or on flows, and/or the threat of potential competition and new entry would act as a stronger constraint.

11.31 In addition to the first three features, we have found a fourth feature, (d), to be present in parts of the North-East of England, relating to the conduct of Arriva and Go-Ahead. This also gives rise to an AEC in a further way. Where all four features apply, geographic market segregation has diminished head-to-head competition and so caused high market concentration. This conduct also reduces the strength of potential competition, as the parties concerned are less likely to enter in head-to-head competition with existing services than they otherwise would. This prevention, restriction or distortion of competition also requires barriers to entry and expansion to be present, as otherwise this geographic market segregation could be undermined by new entry or expansion.

11.32 Below we set out an explanation of each characteristic in more detail and the factors which cause them to arise.

**High concentration**

11.33 The provision of local bus services is highly concentrated. As noted in paragraph 11.28(a), the high concentration feature refers to the extent of overlap between operators’ services causing high concentration at the level of passenger flows, indicating that the constraint from head-to-head competition is uncommon. High concentration can also refer to the limited presence of operators across a wider local area, indicating that the constraint from potential competition will be reduced. We have found that the local bus market is generally stable (see Appendix 6.5), and so high concentration (both in terms of particular flows and routes or wider local areas) will have persisted over a number of years.

11.34 There are several different reasons for the current structure of the bus industry. Several operators noted that the current structure of the market was a result of the way in which the industry was privatized. Existing businesses which served particular geographic areas were sold off as single entities and the continuing businesses reflect this structure. While adjacent businesses were not typically sold to the same operator, subsequent mergers and acquisitions have allowed consolidation along these lines to occur. The development of the structure of the industry is set out in paragraphs 2.36 to 2.42.

11.35 Many of these mergers and acquisitions have been subject to review by the competition authorities. Each will have been evaluated with regard to its particular effects on local competition at the time, but not necessarily with regard to the aggregate effect on market structure over a sustained period.

11.36 We note that depots tend to be of a substantial size. A single depot often represents a substantial proportion of the vehicles operating in a local area. The effective operating radius around a depot is constrained by the costs of dead running and the difficulties in operating a reliable service at a long distance from the depot. Establishing a depot can be costly and in some cases there may be difficulties in finding a suitable site and obtaining planning permission (see paragraph 9.166), and therefore operators generally continue to use existing depots. Other barriers to entry and expansion will also mean that market structure is slow to change. This all means that there could be a limited number of depots in an area and therefore potentially a limited number of operators.

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7 See Section 4.
11.37 Operators have told us that there is continuing structural change in local bus services given acquisitions, expansion and entry in the sector, especially when judged in the context of an industry where overall demand has been in decline. Several operators argued that there were very few opportunities for substantial structural change given that existing service levels were often high and offered by efficient operators. However, we have found that there are limitations in the existing competitive process.

11.38 As noted in paragraph 11.12, we have found in the North-East of England that the extent of head-to-head competition was mitigated by operator conduct leading to geographic market segregation. This segregation was found to be reinforced by a range of operator behaviours including communication, signalling and retaliation, and depot sales that have contributed to our finding on geographic market segregation, see paragraphs 11.48 to 11.52.

11.39 As set out in paragraphs 11.44 to 11.47, the nature of incentives in local bus markets mean that head-to-head competition may not be sustained. This will in itself increase concentration. There are, however, examples where we observe two (or more) operators running a service along the entirety of a route, or where routes overlap to a large extent. We note the circumstances in which this arises, including where competition might be sustained, in paragraphs 8.66 to 8.81.

11.40 Differentiated competition, where it occurs, can still provide a constraint. This may be less than we might expect if head-to-head competition were fully effective but is more likely to be sustainable and less likely to lead to incidents of ‘bus wars’ or other more extreme examples of competition. For example, differentiated providers could compete on service quality and fares for different categories of customer. We note that there are some examples of routes with very heavy demand where effective competition appears to be sustained—see paragraphs 8.76 and 8.77.

**Barriers to entry and expansion**

11.41 Our findings on barriers to entry and expansion are set out in paragraphs 9.210 to 9.226. While entry sometimes occurs (as outlined in Appendix 6.5), we consider that these barriers can limit the prospect of expansion from nearby operators (potential competition) and from new entrants. Consequently, the extent of the constraint from potential competition and new entry is reduced. The following aspects of the market constitute barriers to entry and expansion:

(a) uncertain and potentially significant sunk costs of bringing a route to profitability (see paragraph 9.212);

(b) uncertain and potentially significant costs associated with entering on a route arising from the expectation that incumbent reactions on that route can result, such that head-to-head competition will not be sustained (see paragraph 9.213);

(c) uncertain and potentially significant costs associated with entering on a route arising from the expectation of post-entry retaliation by the incumbent on other routes (see paragraph 9.216);

(d) disadvantages for a potential entrant on a route where the incumbent has existing network strength (see paragraph 9.217);

(e) advantages for larger incumbents arising from an ability to offer more attractive multi-journey tickets than smaller operators, particularly where there is no effective multi-operator ticketing scheme available (see paragraph 9.217);
(f) the difficulty in finding suitable depots (see paragraph 9.218);

(g) disadvantages for a potential entrant associated with gaining fair and reasonable access to bus stations owned and operated by an incumbent operator (see paragraph 9.219); and

(h) ‘cheap exclusion’ engaged in by incumbents (see paragraph 9.220).

11.42 While all these barriers could apply to either small or large-scale entry/expansion, their relative importance can vary according to the type of entrant. For example, large-scale entry might entail greater sunk costs and the anticipation of more vigorous post-entry competition. On the other hand, network and ticketing effects may be a more significant barrier for small-scale entry.

11.43 We note that operators in some cases can enter an area through the acquisition of an existing operator, and adopt different competitive tactics or use it as a basis for expansion. This can, for example, assist with getting access to a depot, acquiring local knowledge, or building up a network of services. A change of ownership does not of itself change concentration in a market. However, changes in ownership may have an impact on competition, for example acquisition of an existing operator by a larger operator may increase the perceived threat it exerts from potential competition (see paragraph 8.149).

Customer conduct

11.44 We found that in general, where bus operators compete head-to-head they do so at least in part on the basis of service frequency. Operators are incentivized to compete on frequency because of the way customers behave. We found that a substantial proportion of customers plan the bus they are going to use in advance and that customers switch between operators at the planning stage of the trip based on a number of attributes of operators’ offerings. However, for single/return/day ticket customers, once at the bus stop these attributes are largely overridden by a bus being first to arrive (see paragraph 8.49). Where passengers choose in advance to use a particular operator’s services or to purchase a return or network ticket, a major determinant of this choice is also the frequency of service (see paragraph 8.50). The evidence we saw indicated that this pattern of behaviour was generally applicable across geographic areas and we did not receive evidence which indicated to us that single ticket customers in any geographic areas would not display this behaviour.

11.45 Moreover, the nature of the bus industry is such that it is very easy for an operator to observe where a rival is operating and the nature of those rival services. In addition any competitive actions can be focused on a particular route, without having to spill over into the operator’s other services in an area.

11.46 As a result of the customer conduct described in 11.44, and the transparency and ability to target discussed in 11.45, head-to-head competition can result in a costly period of rivalry between operators which is likely to be loss-making, and so culminate in the exit of one operator (see paragraphs 8.98 and 8.99). As a consequence head-to-head competition may not be sustained. The anticipation of a costly period of rivalry which could result from entry can act as a barrier to further entry and expansion, see paragraph 11.41.

11.47 This may also incentivize operators to compete in such a way so as to raise the likelihood that their rival exits the route. Thus, competition in these circumstances can result in a range of competitive behaviour encompassing fare reductions, service improvements, frequency enhancements and timetable changes (to run services just
ahead of rivals). While these actions can be beneficial to consumers, they can sometimes be extreme in order to weaken rivals, and tend to persist only in the short term, thus reducing competition and maintaining high concentration in the long term (at the extreme these actions can take the form of ‘cheap exclusion’).  

**Operator conduct and geographic market segregation**

11.48 The fourth feature is operator conduct, by which operators avoid competing with other operators in Core Territories, leading to geographic market segregation. The effect of this geographic market segregation is to reduce the extent of head-to-head competition and to diminish the constraint from potential competition. This conduct may include some or all of: retaliation and signalling; extensive communication between operators at various levels of seniority about their respective commercial operations; and the sale/acquisition of rivals’ assets. We have found that this conduct has taken place in relation to two operators in parts of the North-East of England.  

11.49 We have found that in the North-East and North-West of England the notion of operators having territories is understood and recognized by operators in these areas. The recognition of this notion promotes some common understanding of those parts of an operator’s network on which it will not expect rivals to compete. We refer to such areas as operators’ ‘Core Territories’. There need not be a common understanding of the full extent of each operator’s Core Territory for geographic market segregation to occur. While operators might reasonably wish to serve their Core Territories well, these behaviours will have the effect of reducing or eliminating competitive pressures from rivals within these areas.  

11.50 This behaviour is reinforced by retaliation arising in the event of an operator entering against an incumbent in their Core Territory. We have observed evidence of incumbents retaliating to such entry by increasing competition on shared routes or by entering elsewhere against the entrant’s other routes. The purpose of this is to impose costs on the entrant so as to persuade it to withdraw from the incumbent’s Core Territory and/or to deter similar entry in future. We have seen retaliatory conduct in the North-East, the North-West and Leicester, and indications of its consideration elsewhere (see paragraphs 8.191 to 8.196).  

11.51 The acquisition of assets (such as depots or routes) can provide another means of reinforcing geographic market segregation by reaffirming each operator’s territory and removing overlap between them. Furthermore, the exchange of information may allow an easier understanding of the perceived extent of Core Territories. It may also be used by operators to signal intended retaliation or the withdrawal from periods of costly retaliation to a less competitive state.  

11.52 Even absent explicit communication, Large Operators might independently determine that their long-term profitability is enhanced through avoiding competition with each other. We find that conditions facilitating tacit coordination exist across the reference area (see paragraphs 8.239 to 8.243), and so explicit actions on the part of operators may not be required for geographic market segregation to be achieved. In

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8 ‘Cheap exclusion’ encompasses tactics intended to weaken a rival which do not deliver benefits to customers—see paragraphs 8.275 to 8.277.  
9 In the North-East, we expect that detriment to consumers will have arisen from this conduct. This geographic market segregation will have led to less head-to-head competition in certain parts of the North-East than we would have expected in the absence of the feature, and so a detriment to consumers arises given the benefits that we have found head-to-head competition to bring. Reduced constraints from potential competition will also increase the scale of the detriment arising in Core Territories. We note that in assessing the Transactions, the OFT found that a substantial lessening of competition could arise because of the loss of head-to-head or potential competition on some routes.
conjunction with this finding, it is possible that geographic market segregation could be a more widespread feature than we have identified.

Identification of where AECs arise in individual local markets

11.53 In this section we assess the extent to which the three features in paragraphs 11.28(a) to (c) apply to individual routes and Urban Areas within the reference area, and so give rise to AECs in the way described in paragraph 11.30.

11.54 We have found that at least some barriers to entry and expansion are present in all local markets in the reference area (see paragraphs 9.206 to 9.209). Therefore, it follows that potential competition and new entry will both be weakened as constraints on incumbent operators, at least to some degree, across the reference area.

11.55 Further, given that the customer conduct feature is present in all local markets in the reference area (see paragraph 11.44), whether or not an AEC applies depends on the presence or absence of the high concentration feature in each local market. 10

11.56 Consequently, to determine, in principle, whether there is an AEC in a particular local market, it is necessary to determine whether there is effective head-to-head competition at the flow level. This rule is applied in practice in paragraphs 11.57 to 11.79. Our analysis is carried out at the route level rather than the flow level for the reasons set out in paragraphs 11.57 to 11.60. As well as head-to-head competition we take into account overlaps with rail or tram services and whether the route in question may be expected to sustain head-to-head competition in a well functioning market (see paragraph 11.64).

Application to the local assessment of competition

11.57 It is not possible to carry out an individual assessment of concentration on every flow in the reference area (as well as it not being possible to assess the degree of constraint from potential competition and entry individually for each flow). We estimate that there are several million individual passenger flows within the reference area. 11 To carry out an individual assessment of each flow would necessitate identifying and gathering detailed information about each and every one of these flows. Even if it were possible to surmount the extensive practical and computational difficulties involved in such an exercise, without information on flow-level passenger numbers or revenue it would not be possible to weight the importance of individual flows in aggregating up to an overview of competition in an area. Nor could this flow-level information be used as a basis for further analysis (such as the PCA).

11.58 We considered at the beginning of our investigation whether to request passenger number or revenue information from operators at the flow level (as has sometimes been done for specific merger inquiries). However, in consultation with some of the operators that would be required to construct and provide this information, we found that the collection of flow-level data was not possible as information on where passengers began and ended their journeys was not recorded. Although we might have collected information on where passengers boarded the bus and used this to estimate flow-level information, the enormous burden that this collection exercise would have placed upon the industry would have been disproportionate.

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10 We note, however, that there are some routes that may not be able to sustain more competition. These routes are considered in paragraphs 11.67 to 11.71.
11 Indeed, if the journey between all of the bus stops served by each route in the reference area is considered a potential flow, then we calculate there to be approximately 12.8 million flows in the reference area.
Moreover, we note that competitive strategies are unlikely to be largely determined at the flow level.\textsuperscript{12} Competition between bus operators often happens through changes in the competitive offer at a route level (eg frequency, hours of operation, quality of vehicles etc) or network level (eg zonal pricing and travelcards, overall network level). Nearly all operators and commentators refer to local markets as an area larger than a flow. We want to consider the process of competition in a wider framework to understand how operators compete in practice, as well as allowing us to consider potential competition and new entry. Consequently we have not constrained our consideration of competition in this investigation to frameworks purely on and around individual flows.

We therefore looked at route-level measures for the purposes of identifying relevant markets with features that give rise to an AEC. A full description of the methodology we used to assess head-to-head competition at the route level is provided in Appendix 8.1.

In paragraphs 11.64 to 11.79, we build on our analysis of the extent of head-to-head competition and set out the methodology we use to assess competitive conditions in individual relevant markets within the reference area using route-level information. This methodology allows us to categorize every route in the reference area.

There are almost 18,000 routes within the reference area as a whole. We have undertaken analysis individually for each of these routes; however, because of the volume of routes involved it can be difficult to present the results of route-level measures in a meaningful way. We therefore find it useful to present our route-level findings by aggregating the route-level measures to describe the average extent of head-to-head competition on individual routes that pass through specific Urban Areas.

This and other measures at an Urban Area level, such as shares of supply (subject to some important limitations), are also useful when considering the strength of both head-to-head and potential competition. Measures of Urban Area shares of supply are set out in Appendix 4.3.

Assessment of the extent of competition between local bus operators in individual Urban Areas

This section describes our assessment of the degree of competition between operators in individual Urban Areas, drawing on and developing our analysis of head-to-head competition based on routes as set out in paragraphs 8.9 to 8.17 and Appendix 8.1. We set out in this section:

- our method for identifying rail and tram overlaps;
- the method we use to identify routes where we might not necessarily expect head-to-head competition even in a well-functioning market;
- the system we use to classify routes according to the likelihood that the flows which make up the route are subject to an AEC; and

\textsuperscript{12} Competition could occur at individual flow levels, for example by adjusting the location of fare stages and setting different fares for particular flows. However, we were told that flow-level fare setting was inefficient as passengers found it confusing. Flow-level setting of fares and other elements of the service is also costly in terms of management time. As a consequence, flow-level setting of service and fares is relatively and increasingly rare in practice.
the summary results of this classification exercise, which show the extent to which routes that pass through individual Urban Areas are likely to be subject to an AEC.

Identifying overlaps with rail and tram services

11.65 Appendix 11.2 sets out the exercise we undertook to distinguish local bus routes, within the reference area, that are not constrained by competing rail or tram services from those that may face some competition from a rail or tram service.

11.66 The filtering exercise that we undertook identified 80.5 per cent of local bus routes in the reference area as 'not constrained by rail or tram'. For the remaining routes in the reference area, where there is some overlap with a rail or tram service, there are a number of reasons why it may not necessarily follow, from the existence of an overlap, that there is a competitive constraint on the local bus operator. We therefore find that only a small proportion of local bus routes in the reference area can be classified as having a rail or tram overlap; fewer still will be subject to a competitive constraint from a rail or tram service.

Routes that may not sustain more competition

11.67 We identify an AEC as arising where there are features of a relevant market which prevent, restrict or distort competition. We therefore identify an AEC where, in the absence of these defined features, we would expect more competition. There are two situations where in the absence of the features set out in paragraphs 11.28(a) to (c), we still might not necessarily expect greater competition. These are where the route itself cannot sustain more than one operator and supported services where different conditions apply. We discuss each of these below.

Routes that cannot sustain more than one operator

11.68 In paragraphs 8.24 to 8.26 we conclude that there is no evidence to indicate that economies of scale generally exist at the route level to the extent that they would affect the sustainability of head-to-head competition along a route. In general, therefore, we would expect to see head-to-head competition but for the features outlined in paragraph 11.28.

11.69 Despite this general observation, we considered the possibility that there could be routes where demand is so limited that the route can only support an allocation of a single vehicle (see paragraphs 8.27 to 8.32). In this case, while head-to-head competition is clearly absent, we might not necessarily expect that, but for the features, there would be greater head-to-head competition.

11.70 We used the Traveline database to identify routes in the reference area that, even on the basis of a number of conservative assumptions, have a timetable such that they could not be served by a single vehicle. For routes that meet this threshold, we know that there is currently more than one vehicle running on the route and consequently that the situation described in paragraph 11.69 cannot apply. Routes that do not meet this threshold may be operated by a single vehicle and may therefore be subject to the situation described in paragraph 11.69. This is not to say that these routes are necessarily currently served by a single vehicle, or even if this is the case.

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13 For example, the set of ‘over-lapped’ routes can include routes which do not face effective competition from rail or tram because of factors such as: the rail or tram service has higher fares; operates a different timetable; does not provide a comparable journey time; and cases where the overlap does not correspond to a substantial proportion of passenger journeys on the bus route, see Appendix 11.2, paragraph 3.
that they are necessarily too ‘thin’ to support more than one operator. For example operators with existing services in the area might interwork ‘thin’ routes with other services, routes can be restructured, or smaller vehicles can be deployed.

11.71 We used this measure to establish that 44 per cent of all routes, representing 86 per cent of all bus services in the reference area, were very unlikely to be served by a single vehicle (see Table 8.1). Similarly, of those routes that do not face an overlap of 3.2 km or more, 48 per cent of routes, representing 85 per cent of services, were very unlikely to be served by one vehicle. Consequently, we were able to conclude that ‘low demand’ is very unlikely to explain the lack of head-to-head competition we observe across the reference area. We use the same methodology as a check on our results of route-level analysis where Urban Areas are our unit of assessment.

- **Supported services**

11.72 Supported services are funded by LTAs because they are not commercially viable but serve an important social function. We have assessed the competitive conditions in bidding for local bus tendered contracts separately from the operation of local bus services in Section 13. In general, we might not necessarily expect that supported services would face competition, but for the features identified in paragraph 11.28(a) to (c) which lead to an AEC.

11.73 We found, however, that there might be some interaction between competition in the operation of local bus services and supported services. For example, some supported routes at the margin might be supplied on a commercial basis in a more competitive environment. Supported services may also overlap with and provide a substitute to passengers over part of their route.

11.74 Information on whether a service is supported or not is not available within the Traveline database that we used for our analysis. To understand better the distribution of supported services, we undertook an exercise to match data from 12 LTAs on supported routes to the information in the Traveline database. Details of this exercise are set out in Appendix 11.3. The results of this exercise provide the best available information on the profile of supported services in the reference area.

11.75 We found that within all categories of route (these are categories of route according to the likelihood that effective competition exists, see paragraphs 11.77 to 11.79), the majority of services (more than 76 per cent of services in each category) were identified as not supported. Within the category of routes classified as likely to face competition for all or nearly all flows on the route (category 5), a very small proportion were found to be supported (only 1.3 per cent of services identified as partly or fully supported). Within the category of routes classified as highly unlikely to face effective competition (category 1), a relatively high proportion of services were found to be part supported (19.2 per cent identified as partly supported). For routes where we were unable to dismiss the possibility that the route was operated by a single vehicle (categories 2 and 3), a relatively high proportion of services were found to be fully supported (between 13 and 18 per cent of services identified as fully supported).

11.76 These results show that the incidence of supported services is higher on routes that are highly unlikely to face effective competition than for those routes where it is highly likely that they face effective competition. However, for all categories the great majority of services are commercial rather than supported.
11.77 Each of the indicators of competition, in isolation, can provide only a partial picture of competitive conditions on a route. However, we can combine the results of our route-level tests and provide a more complete understanding of competition on that route and the flows that make up the route. We can categorize routes into groups, depending on the statements we are able to make as a result of those tests. We have identified six categories of route, as summarized in Table 11.1 and explained in more detail in Appendix 11.4.14

<table>
<thead>
<tr>
<th>Category</th>
<th>3.2 km overlap?</th>
<th>90% overlap</th>
<th>Can we dismiss possibility that this is a one-bus route?</th>
<th>Is this route identified as 'not constrained by rail or tram'?</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>AEC highly likely</td>
</tr>
<tr>
<td>2</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Possible AEC—but may have some head-to-head competition from a rival local bus service and/or be a ‘thin’ route</td>
</tr>
<tr>
<td>3</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Possible AEC—but may be a ‘thin’ route</td>
</tr>
<tr>
<td>4</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Possible AEC—but may have some head-to-head competition from a rival local bus service</td>
</tr>
<tr>
<td>5</td>
<td>Yes</td>
<td></td>
<td></td>
<td>Yes</td>
<td>AEC unlikely—most flows are likely to face head-to-head competition from a rival local bus service</td>
</tr>
<tr>
<td>6</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>No</td>
<td>Possible AEC—but may be constrained by a rail or tram service</td>
</tr>
</tbody>
</table>

Source: CC.

Note: N/A = not applicable.

11.78 As discussed in paragraph 11.62, we present our route-level results for individual Urban Areas. Urban Areas refer to cities or towns (or groups of nearby cities or towns) and their nearby suburbs which have a highly interconnected bus network that is in some sense distinct from the wider bus network. There are 239 such areas in the reference area. The full methodology used to construct these areas—setting out how groups of towns with a relatively distinct network of local bus services were identified—is set out in Appendix 4.2. A full list of the names of the settlements contained within each Urban Area, and some illustrated examples of the areas, are given as annexes to that appendix.

11.79 Around 92 per cent of all routes in the reference area, at some point, pass through one of these Urban Areas (after weighting routes by their total weekly frequency), and the Urban Areas which we have defined account for 70 per cent of the total population of the reference area.15

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14 The purpose of the 3.2 km overlap and 90 per cent overlap thresholds is explained in paragraph 8.14.

15 We would expect some people living in the areas surrounding Urban Areas to use local bus services which pass through the Urban Areas, and these individuals will not be included in this figure.
The extent of geographic market segregation

11.80 In relation to geographic market segregation, our finding on the second aspect of the AECs (as set out in paragraph 11.31), relates to the conduct of two Large Operators in the North-East, and so our finding covers only the relevant parts of this area.16

11.81 We have found evidence of the practice or consideration of retaliatory conduct in several areas, and some evidence of communications between operators and consideration of asset sales. We have also found that the conditions to facilitate tacit coordination are present across the reference area, and so explicit actions on the part of operators may not be required for geographic market segregation to be achieved. We note that we have only been provided with evidence of these types of behaviours in relation to three of the five Large Operators and only in limited areas. Nonetheless, we remain concerned that geographic market segregation may be a more widespread problem.

Conclusions on the extent of AECs

11.82 The detailed results of our analysis are set out in Appendix 11.4. Our assessment of the extent of AECs in the reference area builds on our analysis of the extent of competition (see paragraphs 8.9 to 8.17) and also on our consideration of whether routes could sustain more competition (paragraphs 11.67 to 11.71). Our analysis was carried out using the route classification methodology set out in Table 11.1.

11.83 Across the reference area as a whole and in the majority of Urban Areas, a significant number of routes fall into category 1 and are highly likely to be subject to an AEC. Of the 239 Urban Areas in the reference area, there are 212 Urban Areas where the proportion of services identified as category 1 is more than 10 per cent, of which 108 Urban Areas have more than 40 per cent of services on category 1 routes. In the remaining 27 Urban Areas, less than 10 per cent of services are on category 1 routes.

11.84 There are a number of routes in categories 2, 3, 4 and 6 where we are unable to determine whether all the flows that make up the route are subject to an AEC or are not subject to an AEC.17 It is very unlikely that all the routes that lie outside categories 1 and 5 face effective head-to-head competition. We expect that many routes within category 6 will not be constrained by rail or tram services. We also expect that some routes in categories 2 and 3 could be served by more than one vehicle, with many of those routes (all of the category 3 routes and some of the category 2 routes) not facing effective head-to-head competition. In addition, the extent of overlap faced by category 4 routes suggests that, at least in a substantial number of cases, a large proportion of passengers on these routes are unlikely to have a choice of operator. Thus, there are a considerable number of routes in these categories in addition to those in category 1 where we consider it likely that an AEC arises.

11.85 The number of routes and the proportion of services accounted for by category 5 routes, which are unlikely to be subject to an AEC, is typically very small, with only a few Urban Areas having a significant proportion of services accounted for by

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16 Because geographic market segregation, where successful, will create a lack of head-to-head competition, this second aspect of the AEC will apply in addition to the first aspect of the AEC.

17 Routes in categories 2, 3, 4 and 6 account for 3.2, 8.9, 17.4 and 27 per cent of weekly services in the reference area respectively.
category 5 routes. There are only eight Urban Areas with more than 10 per cent of their total services accounted for by category 5 routes.

11.86 Operator conduct leading to geographic market segregation has been found to apply in relation to two operators in certain areas in the North-East of England.
12. Policy and regulation

Introduction

12.1 In this section, we consider whether any aspects of bus policy and/or regulation of the bus industry prevent, restrict or distort competition in the supply of local bus services in the reference area. We look at the extent to which policies reduce incentives to compete or act as an impediment to the competitive process. We also assess whether the effect of policies differs by operator affecting any operator’s relative ability or incentive to compete.

12.2 We recognize that bus policy and regulation is designed to deliver a variety of economic, social and environmental benefits which may not otherwise be delivered by the market. We are conscious that regulation of almost any kind introduces distortions or constraints into a market. In making our assessment of any competition effects, we compare the market outcomes with those expected from an effective operation of the policy or regulation.

12.3 This section is divided into four areas reflecting where responsibility for the policies lies:

(a) national policy relating to bus services (see paragraphs 12.5 to 12.29);

(b) national regulation (see paragraphs 12.30 to 12.79);

(c) local policy implementation (see paragraphs 12.80 to 12.121); and

(d) concessionary travel schemes (see summary in paragraphs 12.122 and 12.123 and detailed analysis in Appendix 12.3).

(e) Further supporting detail on bus policy and regulation is set out in Appendix 12.1. Issues relating to the tendering of supported services are considered in Section 13.

12.4 There are differences in policy and regulation applying in the nations of England, Scotland and Wales. We use the term 'national' policy to describe the policies applied in each of these nations. Policies which apply to the whole reference area, are referred to as 'Great-Britain-wide' (which excludes London).

National policies

12.5 National governments set the national policy for local buses and implement this through legislation, related regulations and guidelines. National governments also provide substantial direct funding support to the industry and set the framework for additional funding at a local level.

12.6 A description of Great-Britain-wide and national policy affecting local bus services and funding arrangements is set out in Appendix 12.1. Policies on local bus services are part of a wider national policy on the transport network. There is increasing government focus on using the transport network to address a number of policy areas including supporting economic growth, tackling environmental issues, such as congestion and pollution, and meeting wider social goals, such as social inclusion.

12.7 As a result of devolution, the Scottish Government and the Welsh Government have been given specific responsibilities for transport policy and implementation in those
nations. The arrangements in England, Scotland and Wales are outlined in paragraphs 12.12 to 12.17.

12.8 We have considered several aspects of national policy: concessionary travel, BSOG, specific rural and urban bus funding and other policy development such as smart ticketing schemes. The concessionary travel schemes are administered in different ways in England, Scotland and Wales. The operation of these schemes is considered separately in paragraphs Appendix 12.3. The other areas are discussed below.

12.9 We first set out differences in national arrangements and then consider specific policies.

National arrangements

England

12.10 DfT policy has been set out in a number of documents covering local bus services in England—see Appendix 12.1, paragraphs 3 to 18. Recently the Local Transport Act 2008 (see Appendix 12.1 paragraph 11) was implemented. The Coalition Government has said that ‘We … will encourage joint working between bus operators and local authorities’. It has set out more detailed plans in the Local Transport White Paper.¹

12.11 At a local level, LTAs are required to produce a Local Transport Plan (LTP) setting out their local transport strategies and an implementation programme. This plan includes the LTA’s approach to bus services. LTAs are expected to contribute to the DfT’s key national transport goals (see Appendix 12.1 paragraph 11), although the DfT does not formally assess plans. Central funding for the transport policy of LTAs/local authorities is not generally ring-fenced.

Wales

12.12 The Welsh Government told us that generally the legislative and regulatory framework around bus service registration, operator licensing and the Traffic Commissioner was not devolved, but other aspects of bus policy were. For example, Welsh Ministers have devolved powers in relation to the provision of tendered services, to make regulations and prepare guidance on bus quality partnerships and quality contracts, to make regulations on concessionary fares and safety, facilitate smartcard ticketing, and to provide subsidies such as BSOG and a Local Transport Services Grant.

12.13 The Welsh Government has published a Welsh Transport Strategy² which sets out the Welsh Government’s aspirations for an integrated transport network in Wales and provides the strategic framework for bus services in Wales.

12.14 There are four regional transport consortia (SEWTA; SWWITCH; Taith and TraCc) across Wales—see Appendix 12.1, paragraph 24. The Welsh Government has approved a Regional Transport Plan in each area for the period 2010 to 2015. It provides general funding for LTAs which is not ring-fenced through Revenue Support

¹ The Local Transport White Paper can be found at www.dft.gov.uk/pgr/regional/sustainabletransport/.
² One Wales: Connecting the Nation, Welsh Government (published April 2008), which can be found at: http://wales.gov.uk/deel/publications/transport/wts/wtsstrategy/wtspdfloen.pdf;jsessionid=1TH5N1fU31CBbt3vBXRbyhcBVn1JQTTcQF29kBjyksRvgwZdF/1312433909?lang=en.
Grant. However, in addition there are specific grants such as BSOG and Local Transport Services Grant as well as the concessionary travel scheme.

Scotland

12.15 The Scottish Government sets Scotland’s national bus policy and has introduced specific transport legislation. Certain reserved matters are still the responsibility of the UK Parliament, for example road safety and licensing. It produces its own transport strategy taking account of what it has described as specific problems and issues between regions.

12.16 The Scottish Government funds local authorities through their block grant settlements to support bus services through local authority tendered services. In addition, it finances local authorities to deliver the Bus Route Development Grant aimed at providing financial support for up to three years to aid the development of new and existing registered local bus services which have the potential for growth.

12.17 Seven Regional Transport Partnerships have responsibility for strengthening the planning and delivery of regional transport (see Appendix 12.1, paragraph 29).

Assessment of impact of national policies

BSOG

12.18 Historically BSOG has been paid to all operators of registered local bus services and offsets a high proportion (around 80 per cent) of the duty paid on fuel consumed. In England, current payments are over £400 million a year but they will be subject to a reduction of 20 per cent from 2012, as a consequence of the 2010 comprehensive spending review. In addition, the basis for making payments in England is subject to variations with enhancements, for example to payments where operators run low-carbon buses or have smart ticketing technology. The Government has also said that it ‘…will work with bus operators and local government to examine smarter ways of administering this subsidy to get better results for passengers and taxpayers’.3

12.19 The Scottish Government told us that in Scotland, the link between fuel duty and BSOG was removed on 1 April 2010. Payments to operators are instead now calculated on the eligible kilometres run on local bus services, the total volume of fuel used and a predetermined payment rate set by Transport Scotland (currently 41.21p per litre). An additional incentive was introduced for low-carbon vehicles. The Scottish Government told us that it was currently reviewing BSOG to align it better with its strategic objectives.

12.20 In Wales, the Welsh Government continues to pay BSOG on the basis of the amount of fuel used, although Welsh Ministers have recently written to bus operators breaking the link between rises in fuel duty and automatic increases in BSOG. The Government has worked with bus operators and local authorities to review the grant scheme and a range of options will be considered by the new Welsh Government. No incentives have been introduced.

12.21 BSOG is effectively a subsidy that reduces mileage costs incurred by local bus operators, and so more services are likely to be viable. This might allow greater frequencies on some routes and more marginal routes to run on a commercial basis.

It is, in part, intended to encourage passengers to switch from private cars to buses. Since BSOG applies equally to all local bus operators, we do not consider that it will distort competition between them.

12.22 The reduction in BSOG is likely to have the effect of making some previously commercial services unviable. In particular, routes with relatively high fuel consumption (eg more lightly-utilized and longer-distance rural routes) may become unviable, and may stop operating commercially. In addition, the DfT told us that the consequence of a reduction in BSOG (which was normally payable on ‘dead mileage’ between a depot and the start of a route) was that it would increase costs to operators in running empty buses to and from their operating area. This may reduce the area around depots in which operators may consider running services and hence be relevant to our assessment of the extent of local markets and potential competition.

12.23 The DfT is undertaking a review of the way in which BSOG is administered and in its response to the Remedies Notice asked the CC to consider whether BSOG could be used to improve competition and passenger outcomes. We set out our consideration of this request and a resulting recommendation to the DfT, together with its response in paragraphs 15.421 to 15.430.

Targeted national funding for local bus services

12.24 All the nations have run specific initiatives to help develop local bus services, particularly in rural areas. The DfT has at times run Rural and Urban Bus Challenge competitions to stimulate the development of innovative ways of meeting accessibility and social inclusion needs in urban deprived areas, for example demand-responsive services and taxibuses, and also for rural community projects. These schemes were intended to provide temporary funding, and where successful they could become part of mainstream funding from local authorities and other sources. Similarly, the Welsh Government operates a Local Transport Services Grant scheme (worth £11million in 2011/12) which can be used by LTAs to finance a range of initiatives to support the provision of socially necessary and rural bus services, and Scotland has historically awarded Bus Route Development Grants.

12.25 One example is Kickstart funding, first introduced by the DfT on a pilot basis in 2003, with a further competition in 2005, where £20 million was awarded to 43 projects. In 2009, £25 million was made available under the competition. This provided start-up funding to new bus services, or bus service enhancements. It was targeted at schemes that had the potential to become successful but which initially might be marginal in commercial terms and require some financial help to start them off, or at marginal schemes at the time that with some extra support could be made more successful.

12.26 As these are run as open competitions for funding with specific policy-focused aims, we do not consider that these result in any restriction or distortion to competition in local bus markets.

Other policy developments

12.27 The Coalition Government has set out its detailed policy plans in the Local Transport White Paper. DfT ministers have highlighted the key overarching policies, namely ones which help grow the economy and help tackle carbon emissions, while not

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4 DfT response to the Remedies Notice, paragraph 27.
neglecting other important priorities, including road safety, affordability, accessibility, and people’s health and wellbeing—for example, through more cycling and walking. There have been the changes to BSOG (outlined above) and to concessionary fares (see Appendix 12.3 paragraph 18 and Annex A) and a number of other consultations, for example changing the notice periods for the registration of local bus services and on the impact of buses on air quality.

12.28 Some areas of policy are in development. For example, smart ticketing is being introduced by operators and authorities in certain parts of England with encouragement and funding from national government. All ENCTS concessionary bus passes are ITSO smart tickets, which can be used smartly in areas which have been equipped with smart ticketing, or as flash passes on those vehicles which have not yet been equipped. The plans for England were set out in the Local Transport White Paper published in January 2011. Smart card ticketing infrastructure, compliant with the ITSO specification, has also been rolled out across buses in Scotland and Wales.

12.29 We have not found any concerns with national policy in the local bus market. The general approach has been to encourage the development of local bus services and at the same time to give significant local discretion to LTAs and/or regional partnerships.

**National regulation**

12.30 In this section, we consider the specific measures that are in place to regulate the local bus industry. In particular, we look at the role of the Traffic Commissioners in granting licences for local bus service operators and agreeing service registrations and at the competition enforcement powers of the OFT.

**Traffic Commissioners**

12.31 The bus industry is subject to regulation by the Traffic Commissioners. The mission of the Traffic Commissioners is ‘to champion safe, fair and reliable passenger and goods transport’. In addition, operator licensing is ‘about managing risks to safety, allowing fair competition whilst also seeking greater reliability for passengers’ although the Senior Traffic Commissioner told us that fair competition was not a defined concept and there were no issued guidelines on this. We discuss the concept of fair competition in paragraph 12.53.

**PSV operator’s licence**

12.32 Local bus operators are required to hold a PSV operator’s licence granted by the Traffic Commissioner for their Traffic Area. To be eligible for an operator’s licence, the applicant must be of good repute, be professionally competent and have appropriate financial standing.

12.33 Good repute relates to issues such as whether the operator has relevant convictions (for example, serious criminal offences or road transport offences) and whether there are other relevant matters relating to previous operation of vehicles. The test for pro-

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7 Local Transport White Paper, paragraphs 6.5–6.18 (see above).
8 The Senior Traffic Commissioner provides direction and guidance to the Traffic Commissioners. These only apply to the Scottish Traffic Commissioner in respect of reserved matters, and not devolved powers.
fessional competence is satisfied by an operator holding a certificate of professional competence to act as a transport manager (or the operator employing someone who holds a certificate). We did not receive any submissions suggesting that these tests restricted competition in any way.

12.34 The test of appropriate financial standing is fixed by EU Regulation as adapted by government. The Traffic Commissioner needs to be satisfied that an operator has sufficient finance at its disposal to run a business properly, on a continuous basis. The Senior Traffic Commissioner told us:

These minimum available funds per vehicle are required in order to ensure proper launching and proper administration of the undertaking and in particular to enable the undertaking at all times to keep its commercial vehicles maintained in a legal, roadworthy and a safe condition so that it is not competing unfairly in the market for road transport.

12.35 For a standard national licence, the financial requirements will be met through demonstrating funds of €9,000 for the first vehicle and €5,000 for each additional vehicle (this is converted annually into a sterling equivalent).

12.36 The Senior Traffic Commissioner told us that the principal means of demonstrating financial standing for all sizes of undertaking was their cash position. For sole traders, partnerships and limited companies with an annual turnover of less than £5.6 million, ‘funds at their disposal’ would normally be assessed by reference to the average daily closing balance of their bank account for the three months preceding the application, including any bank-authenticated overdraft facilities. However, for larger companies, the audited accounts might be considered sufficient. He explained that since companies with a turnover of over £5.6 million a year were required to have their accounts independently audited, such companies could demonstrate their financial standing through their accounts if they were able to show that they were trading profitably and that their assets at least matched their liabilities. The Senior Traffic Commissioner told us that the processes and timetables for consideration of decisions were the same for small and large operators.

12.37 We received some comments on these requirements. ALBUM (the Association of Local Bus Company Managers) told us that the requirements for financial standing favoured the larger operators. They were able to move funds around between subsidiaries or submit a letter indicating that funds would be moved if necessary, and were not required to produce daily bank statements at licence renewal time, or any other time directed by the Traffic Commissioner, unlike smaller operators. One smaller operator (The Big Lemon) also told us that smaller operators with less experience found it very difficult to access finance. It had also found the application process for a licence difficult and thought that the fees fell disproportionately on smaller operators because the fee for an operator’s licence is the same regardless of the size of operation. EYMS told us that the financial standing rules meant that a new entrant had to provide financial assets over and above those needed to operate, which could be difficult and sometimes expensive to arrange if banking overdraft facilities were required. Wiltshire LTA stated that a new operator would require an application to be backed up by a bank deposit for each vehicle on its licence, available for immediate withdrawal. It said that an LTA might be unable to award contracts to an operator without a current PSV operator’s licence, yet it was often the

11 Directive EC 96/26. We note that from December 2011 the requirements are to change and will require all operators to provide certified or audited accounts to prove financial standing.
12 The Big Lemon response to provisional findings, paragraph 1.
security of a local authority contract which was needed to persuade a bank to provide finance to meet the above requirements. It said that this created a ‘chicken and egg’ situation which could be very difficult for a new entrant to the bus industry to overcome.

12.38 The requirement to have funds available on deposit creates a cost of entry for operators, and means that if their ability to raise finance is constrained, the amount of finance left over to fund investment and expansion may be reduced. Compliance with the conditions of a PSV operator’s licence will also involve some time and cost. We considered whether this created a barrier to entry for bus operators. We note that there are many instances of small-scale entry into the bus industry. While in principle the effect of the conditions may be to disadvantage smaller operators, we received little evidence from operators indicating that their ability to enter and expand had been restricted in practice. Given that any system of licensing will need to take account of EU requirements and that we did not identify any specific distortions to competition introduced through the implementation of the scheme, we do not find that the licensing requirements result in any AEC.

Registration of local bus services

12.39 All commercial and supported local bus services outside London must be registered with the Traffic Commissioner for the relevant Traffic Area. The Senior Traffic Commissioner told us that the registration system provided an important element of stability in the local bus network and ensured that passengers could have confidence that individual services would run according to the route and timetable.

12.40 Bus operators are required to give notice to their local Traffic Commissioner of an intention to commence a local bus service. In general, a 56-day notice period is required in England and Wales, although the Traffic Commissioner has discretion to accept shorter periods. The operator has to provide the Traffic Commissioner with information in relation to the proposed route, the terminal points, timetable and stopping arrangements, and the vehicles that will be used. Any subsequent variation or withdrawal of the service must also be notified giving the same notice period. In Scotland, bus operators are also required to give an extra 14 days’ notice to LTAs.13 In 2010, the DfT consulted on introducing a similar additional 14-day notice period to LTAs in England and Wales.14 It said that this would allow LTAs time to discuss potential concerns with the operator (eg on traffic congestion and road safety) before an application was made, more time to consider whether changes to supported services would be required, and more time to update passenger information. A decision on this proposal has not yet been announced. In 15.110 we make a recommendation that this 14 day notice period is also introduced in England and Wales.

12.41 The Senior Traffic Commissioner told us that the current notice period had three purposes:

(a) First, it restricted how frequently operators may make changes to their services so that passengers were not confused or dissuaded from using the bus because of frequent changes.

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13 Furthermore, in Scotland an operator must run the service registered for a period of at least 90 days from the date on which the registration notification period expires before the operator can make variation to, or cancel the service.

(b) Second, it provided advance notice to other operators of forthcoming changes to the local bus network and allowed LTAs time to decide whether to adjust their network of supported services to cater for the changes.

(c) Third, it allowed time to update passenger information on service timetables.

12.42 The operator must run the bus service according to the specification in the registration. However, in the case of the registration and operation of a ‘frequent’ service (that is, one with at least one bus running every 10 minutes), the operator does not have to specify a timetable and is therefore able to alter service timings without further reference to the Traffic Commissioner. The Senior Traffic Commissioner said that this was considered to be the frequency at which passengers were likely to turn up at a bus stop without checking the timetable, and so monitoring was focused on service intervals. The notice period for minor variations to timetabled services (those that involved a change to the timetable of less than 10 minutes’ difference) can be reduced at the Traffic Commissioner’s discretion.

12.43 Using the Traveline database (see Appendix 4.1 for an introduction to this database), we have found that approximately 3.6 per cent of all routes in the reference area have at least one hourly period in their weekly timetable in which more than 12 services are operated and so are likely to be classed as frequent services (ie at least one bus every 10 minutes in each direction). While this number is quite small, these routes account for a much larger proportion of all services because of the number of buses running on them; they account for 26.8 per cent of all routes in the reference area when each route is weighted by total weekly services (ie scheduled journeys).

12.44 The Senior Traffic Commissioner has published a Practice Direction on bus standards,15 which states that bus operators are expected to work to a target of 95 per cent of their timetabled services leaving the timing points16 for the route within the accepted tolerance of ‘up to one minute early or up to five minutes late’. For frequent services, the Traffic Commissioners expect that (on 95 per cent of the occasions that the service is sampled) six or more buses will depart within any 60-minute period and that the interval between buses will not exceed 15 minutes. Failure to respect these limits (without reasonable excuse) can lead to the Traffic Commissioners taking action (see paragraphs 12.54 to 12.62).

12.45 We consulted on whether the process of registration and the notice periods involved had any adverse impact on the process of competition.

12.46 Two small operators (The Big Lemon and DRM (Bromyard) told us that the registration process was cumbersome and long. The Big Lemon also said that the 56-day notice period to deregister services was too long when a company faced financial difficulties, which could lead to reluctance to offer new services, particularly for smaller operators, as this period of loss-making operation would act as a sunk cost. The Big Lemon told us that it agreed with the principle of the 56-day notice period in order to ensure continuity of services but it thought that consideration should be made by Traffic Commissioners of financial realities faced by operators when applying this principle. The Big Lemon said that smaller operators did not have the same access to finance as larger operators, and therefore could face difficult choices between compliance and bankruptcy.

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15 Can be found at www.dft.gov.uk/vosa/repository/PD%20standards%20for%20local%20buses.pdf.
16 Certain bus stops may be designated as timing points where adherence to the timetable may be measured; buses will tend to wait at these stops if running ahead of schedule. Guidance on timing points can be found in paragraph 19 of www.dft.gov.uk/vosa/repository/PD%20standards%20for%20local%20buses.pdf.
12.47 In contrast, Large Operators and LTAs were generally supportive of the registration process and associated notice periods. In particular:

(a) Arriva told us that 56 days was a relatively short period compared with equivalent periods in other industries, such as the time it may take to get planning permission and build a new trading outlet or assign or surrender rented property. However, it told us that even a 56-day notice period brought some network stability to the industry which was important to bus users and stakeholders and provided time for the service to be properly promoted.

(b) FirstGroup told us about the need to balance the ability to respond quickly to changing circumstances and the need to give fair and due warning to the relevant local authorities and customers and to ensure that the public is properly advised and material distributed. It considered that, whilst different operators may take a different view on risk, the 56-day notice period would be a relatively small proportion of the length of time over which any reasonable operator would seek to test the market.

(c) Stagecoach told us that it was not unreasonable to expect operators to consider, in advance of commencing providing a service, whether the service had a prospect of success.

(d) Metro told us that it was open to operators to register a service for a fixed term to limit any exit barriers if the service did not develop as planned.

(e) Strathclyde Partnership for Transport told us that the notice period to deregister services was firmly in the interests of the travelling public. Although it provided a minimal period of notice of service changes and often presented challenging timescales, it allowed for appropriate replacement services to be arranged if socially necessary, possible and affordable. Furthermore, the provision of quality public transport information—as required by legislation—is barely achievable within the current registration period and therefore any reduction to the current timescales should be avoided.

12.48 We found that there was little evidence that the registration process, where common for all operators resulted in any significant barrier to entry. The requirements to notify changes to service frequencies add a degree of transparency to the intentions of operators as these registrations are available for public inspection. Therefore, competitors will be aware when an operator registers a new or changed service. However, we received no evidence that this resulted in any unequal treatment between operators. As discussed in paragraph 15.112, requirements for the registration of services and notice periods help provide stability in the provision of services for passengers and local authorities.

12.49 However, we were concerned that operators of services which qualified as frequent services could increase frequency to an unlimited extent on the relevant route in response to entry or expansion by another operator with no notice period. This potential for ‘flooding’ the route introduces an asymmetry between the incumbent operator and an entrant or existing operator of a timetabled service. We noted that routes with a least one existing frequent service were likely to have relatively high patronage and could be some of the most profitable or otherwise be attractive to entrants. Whilst we recognized that frequent service registrations allow an element of operational flexibility we concluded that the very wide degree of flexibility contributed to barriers to entry and expansion associated with the expectation of post-entry competition. In Figure 15.2 and in paragraphs 15.110 to 15.220 of Section 15 we recommend changes to the system for the registration of Frequent services.
Traffic regulation conditions

12.50 Traffic Commissioners can determine ‘traffic regulation conditions’ at the request of an LTA, which then apply to all local services in the area (or to a particular class of service). Such conditions may be imposed only when required to prevent dangerous traffic conditions, reduce severe traffic congestion or reduce noise and air pollution, and these conditions may limit the number of vehicles which may be used, the frequency at which vehicles may be operated or where and for how long a vehicle may stop or turn.

12.51 We recognize that these are used for specific purposes and we have not received any evidence to suggest that these are not used appropriately or that the way in which these are applied results in any distortions.

12.52 The effect of these conditions may be to restrict the potential for competition in circumstances where the maximum number of permitted vehicles is already operating in a specified area, thereby preventing a potential operator from launching a competing service. However, the circumstances in which a traffic regulation condition would be made are highly unusual; their nature is to address severe local problems in exceptional circumstances, such as where there is extreme traffic congestion, or there are dangers arising for road users. Further competition may therefore not be possible or appropriate in this context. Consequently we do not find these to give rise to an AEC.

Ensuring fair competition

12.53 We now consider what the objective of ensuring fair competition means in relation to the activities of Traffic Commissioners. The concept of fair competition is central to the functions of Traffic Commissioners. However, it is necessary to look at practical examples of consideration of fair competition to gain an understanding of what this means, as there are no defined guidelines. We have been told that in practice ‘unfair’ competition has been taken to mean:

- not complying with conditions of a licence or registration as compliance has a price which other operators will be meeting and they would be disadvantaged by non-compliant operators;
- choosing not to pay taxes which put an operator in an advantaged position compared with other operators;
- deliberately using buses to ‘jump’ in front of another operator and ‘steal’ passengers and block competitors’ buses; and
- specific attacks on other operators or issues with driver conduct.

12.54 We have been told that Traffic Commissioners can use the powers available under section 26 of the Transport Act 1985 to address issues of unfair competition. Section 26(d) sets out in particular that licence conditions or restrictions can be imposed where a Traffic Commissioner finds that there has been intentional interference with the operation of a service provided by another operator, where a service has been operated in a dangerous manner or where there has been any other serious misconduct in relation to the operation of the service.

12.55 From this, we note that the concept of fair competition is not intended to involve an all-encompassing consideration of competition between operators as this is not within the scope of the activities of Traffic Commissioners. As a result, for example, it does
not cover pricing behaviour. We have been told that looking more widely at whether services were running effectively is not really within the scope of Traffic Commissioners. The Traffic Commissioner for the North West, for example, told us that there would be difficulty in looking at situations where operators decided to register to operate services on exactly the same headways unless she was asked on safety grounds to apply traffic regulation conditions. In addition, she questioned whether, in an area where it was judged that the maximum number of buses was safely operating, it would be fair for a new operator to be denied access based on the fact that others got there first. The Senior Traffic Commissioner told us that Bus Compliance Officers would not investigate undercutting of fares, or the fact that one operator had increased the frequency of the service to compete, provided of course that the revised frequency had been properly registered and the service was operating to that frequency. The Traffic Commissioner for West Midlands and Wales told us that as someone untrained in competition law he thought many of his counterparts would be unclear as to what would be unfair or illegal under competition law if that was something he was required to look at. The Traffic Commissioner for the North West told us that no specific cases of under-pricing had been referred to her, nor would she have the resources to look at this.

12.56 Many of the Traffic Commissioners told us about the role of informal discussions with operators to resolve problems without the need for a public inquiry. We were told that the negative impact of possible adverse findings on reputation was a factor for larger operators, whilst financial penalties could be more relevant to smaller operators.

12.57 The additional power to cancel an operator licence through the withdrawal of an assessment of the operator being of ‘good repute’ is also available, although there is a reluctance to use this in all but the most extreme cases. The Traffic Commissioner for West Midlands and Wales described this as a ‘blunt instrument’ and the Traffic Commissioner for the North-West said that she would hope not to have had to reach this stage.

12.58 A point made by several Traffic Commissioners was that in general, matters had to be referred to them for them to act on a complaint, and that a complainant needed to produce sufficient evidence.

12.59 The issue of resources was a common point put to us by Traffic Commissioners. For example, as set out in Appendix 6.6, paragraphs 22 to 24, we have heard that monitoring may prove ineffective, due to lack of resources and the difficulties of proving such allegations. Where investigations could take several months, operators could gain an unfair commercial advantage over the other operators. We were generally told that the ability to monitor compliance with these requirements had been limited by a lack of VOSA bus compliance officers. Therefore, attention had tended to be focused on instances where complaints had been received by VOSA and the Traffic Commissioners. We noted that the Traffic Commissioners for Scotland and Wales have additional resources available to them compared with their counterparts in England.

12.60 We were also made aware of changes underway to the support provided by VOSA to Traffic Commissioners as a result of a recent change in DfT policy. In the past, Traffic Commissioners would have some bus compliance officers available to them, whose job it was to investigate bus services on the ground in response to complaints, and to monitor services (including large-scale monitoring exercises) and to report to the Traffic Commissioners. These bus compliance officers are now being replaced by a certain number of traffic examiners (whose main role was to examine operators' records of driving and other duties) and vehicle examiners (whose main role was to
examine vehicles to make sure they were safe), who are being trained to take on the bus compliance work (as Bus Operator Account Managers—BOAMs).

12.61 The nature of the work has also changed from inspections on the ground to visiting operators and asking them about their procedures to ensure that their services were running on time, and to see whether these procedures were working. They will also find out how the operators are working in partnership with local authorities and if they are not, the operators and local authorities will be encouraged to work in partnership to promote more reliable services. The operator will then be visited some months later to see if there has been an improvement to the reliability and punctuality of the operator’s registered services. If services did not improve, or if the operators failed to cooperate with the BOAMs they would be referred to the Traffic Commissioners. The Deputy Senior Traffic Commissioner is working with the DfT and VOSA to establish a clear process in such cases.

12.62 In certain cases, Traffic Commissioners are clear that their powers give them sufficient ability to deal with operators that try to compete unfairly—for example, by not complying with regulations or through blatant interference with other operators. However, in cases where operators attempt to steal other operators’ business or register similar timetables, Traffic Commissioners seem not to have a clear mandate to act unless there are safety or congestion issues and particularly where these are raised by the local authority. We note that the Traffic Commissioners are not economic regulators, and that they deal with fair competition in the sense of ensuring compliance with applicable licence terms and registrations. In some cases, this may involve dealing with driver behaviour where this is not consistent with such terms, for example stand blocking.

**Competition law framework**

12.63 In the UK, competition law is primarily applied and enforced by the OFT. The Competition Act 1998 (the 1998 Act) gives the OFT powers to apply, investigate and enforce the Chapter I and Chapter II prohibitions under the 1998 Act which prohibit anti-competitive behaviour that affects trade in the UK. The OFT also has the power to enforce Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), which prohibit anti-competitive behaviour that affects trade in the EU. The Chapter I and Chapter II prohibitions are closely modelled on the EU provisions.\(^\text{17}\) Agreements and behaviour which infringe these provisions are void and unenforceable and the parties may be fined and may be liable to compensate third parties adversely affected.\(^\text{18}\) Under the 2002 Act, the OFT and the CC have powers to investigate certain anticipated and completed mergers, including local bus mergers that qualify for investigation.\(^\text{19}\) The 2002 Act also established the market investigation regime, under which this investigation is being held, and which permits the OFT (and concurrent regulators) to refer for detailed investigation by the CC markets where it appears to the OFT that competition is being prevented, restricted or distorted.\(^\text{20}\)

12.64 The Chapter I prohibition of the 1998 Act provides that agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the UK and have as their object or effect the prevention, restriction

\(^{17}\) The Treaty on the Functioning of the European Union (TFEU) and the Act both prohibit, in certain circumstances, agreements and conduct which prevent, restrict or distort competition, and conduct which constitutes an abuse of a dominant position.

\(^{18}\) Moreover, individuals who are involved in price fixing or market sharing, among others, might if convicted of the cartel offence be imprisoned or fined; directors may be disqualified from so acting for up to 15 years if their companies infringe the competition rules.

\(^{19}\) Section 22 for completed mergers and section 33 for anticipated mergers.

\(^{20}\) Section 131.
or distortion of competition within the UK are prohibited unless they are excluded (section 3 of the 1998 Act) or exempt (section 2(1) of the 1998 Act).

12.65 The Chapter II prohibition of the 1998 Act prohibits the abuse of a dominant position, including exclusionary behaviour by dominant firms, such as predation. The types of behaviour that are illegal under Chapter II are among the more extreme forms of conduct that contribute to the barriers to entry associated with the expected intensity of post-entry competition.

12.66 There are two relevant exceptions to the 1998 Act which apply in certain circumstances in the local bus market:

(a) A ‘block exemption’ from the 1998 Act was adopted in 2001 (the Ticketing Block Exemption).\(^{21}\) This allows categories of particular agreements to be exempted from the application of the Chapter I prohibition. Ticketing schemes will be covered by the block exemption provided that they satisfy certain conditions. Details of the conditions of the exemption are given in Appendix 12.1, Annex A.

(b) The OFT also has established the Competition Tests under the 2000 Act (as amended) or as appropriate under the Transport Act (Scotland) 2001. These tests, which are set out in Schedule 10 of the 2000 Act, apply to different kinds of schemes and agreements entered into by LTAs and bus operators. The OFT has produced guidance primarily to assist LTAs and bus operators to assess whether arrangements entered into by them comply with competition law. Details of the Competition Test are given in Appendix 12.1 Annex B. Where the relevant Competition Test is met, the agreement, scheme or proposed scheme will be deemed to comply with UK competition law.

12.67 The merger provisions of the 2002 Act enable the OFT and the CC to identify and, where necessary, remedy those mergers between bus operators that lead to an SLC.

12.68 We note that the framework for competition policy is currently under review by the Department for Business, Innovation and Skills (BIS).\(^ {22}\)

**Enforcement of the 1998 Act**

12.69 The OFT receives information about possible breaches of competition law in a number of ways, including through its own research and from complaints. It selects which cases to investigate by applying prioritization principles to determine where best to allocate its resources. This means that the OFT will not automatically investigate every potential breach of competition law. Where appropriate, the OFT may make a decision on whether an infringement has taken place after conducting a full investigation using its investigative powers. Nevertheless given the harm to competition and the consequences of infringement, businesses are generally advised to adopt compliance programmes, on which the OFT has recently published advice.\(^ {23}\)

12.70 The OFT told us that it received a high number of complaints about allegedly anti-competitive conduct in local bus services relative to the size of the industry in the

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23 Available on the OFT website at www.oft.gov.uk/OFTwork/competition-act-and-cartels/competition-law-compliance/. This includes guidance to directors on their responsibilities under competition law.
total economy. In its decision document to refer local bus services to the CC, it stated that (paragraph 4.41):

Since the CA98 came into force in March 2000, the OFT has received around 30 complaints concerning predation or other forms of exclusion in bus markets, approximately one every four months. Out of these, the OFT has made one infringement decision, one non-infringement decision, and has in addition undertaken four other investigations.

Since the start of the CC’s investigation we have become aware of several other incidents. These are set out in Table 1 of Appendix 6.6.

12.71 Some operators have told us that the process of pursuing a complaint with the OFT in relation to the Chapter II prohibition could take considerable time and would not necessarily be taken forward. This may act as a disincentive to bringing complaints to the OFT’s attention, particularly in light of the characteristics of bus markets (i.e., transparency, mobility of assets and speed with which incumbents can react to new entry) that mean that harm may be inflicted on a competitor relatively quickly. We noted that the majority of complaints made to the OFT were dismissed on the grounds of administrative priority.

12.72 We accept that formal investigation of potential breaches of the 1998 Act will need to follow a thorough and fair process and that this will take time to deliver. As with any decision on competition enforcement, there will be the possibility of appeal which can add to the time taken to reach a final outcome. In the context of the bus industry, agreements between competitors or incidents of possibly predatory behaviour may refer to specific routes or local markets which are relatively small compared with some cases which may be raised with the OFT. We also accept that the OFT will need to prioritize those cases that it judges are most worthy of pursuing and cannot investigate in full every allegation that is made to it.

12.73 However, in the context of this particular industry, operators that might be perceived as small, when considered on a national scale, may nevertheless have a significant competitive impact in the local markets in which they operate. Moreover, the cumulative effect of anticompetitive agreements or conduct can be substantial, both within individual bus markets and sometimes more widely. These factors indicate an important ongoing role for enforcement of the 1998 Act, which we discuss further in Section 15 on remedies.

Merger control

12.74 The OFT has a duty to refer a merger to the CC where it believes that there is a realistic prospect that the merger has resulted in or may be expected to result in an SLC in a market or markets in the UK. The CC will then conduct an inquiry into whether or not an SLC arises and if so will determine what remedies are appropriate. Instead of making a reference, the OFT may accept suitable undertakings to remedy the SLC or its adverse effects. The OFT’s duty to refer is also subject to a number of exceptions exercisable at the OFT’s discretion. Not all mergers reach the threshold and some can be cleared on de minimis grounds. We noted in paragraphs 2.38 and

24 See www.oft.gov.uk/shared_oft/reports/transport/OFT1158_Local_bus_services.pdf.
26 See Appendix 6.6, paragraph 2.
27 The OFT has discretion not to refer if the merger is insufficiently advanced to warrant reference; if the market is of insufficient importance to justify a reference; or if there are obvious benefits to customers that outweigh the AEC.
2.39 the high relative number of mergers in this industry and the extent of regulatory review and intervention.

12.75 As demonstrated by the Stagecoach/Preston merger investigation,\(^{28}\) the CC has effective powers to remedy anticompetitive mergers, even when they have been completed prior to reference, and will put in place robust interim measures to preserve its ability to require divestiture where this is necessary.

12.76 We discuss and make recommendations about the future application of merger control as part of a package of market opening remedies, in paragraphs 15.339 to 15.370.

**Burden of regulation**

12.77 As the impact of regulation can be cumulative, we have assessed whether the overall burden has a disproportionate effect on certain operators. We have considered some specific types of local bus regulation but note that there are additional requirements, for example to introduce low-floor buses by 2016/17, and that emissions standards for buses are becoming more stringent.

12.78 Several operators told us that the overall burden of regulation in the industry was excessive and so might impede operators’ ability to operate bus services and might deter entry. EYMS told us that it was aware of very recent cases outside its operating areas of small operators ceasing to trade because of ‘red tape and spiralling costs’. While we received indications that the burden of regulations may be high, we were not shown evidence that the overall burden acted as more of a barrier to entrants than the impact it had on those already in the industry. FirstGroup, Stagecoach, Arriva and National Express told us that regulation was not a barrier to entry. Go-Ahead, however, believed that traffic regulation conditions\(^{29}\) and Low Emission Zones\(^{30}\) could limit access to the market and impact smaller operators less able to afford newer compliant vehicles. One mid-tier operator, Cardiff Bus, raised concerns about the overall burden of regulation acting as a barrier to entry. Most small operators that responded to our question in this area (130 of a total of 164) said that local and national transport regulation did not limit their ability to compete against other operators.

12.79 We note that regulation contributes to the sunk costs of entering the market and could be a barrier to entry for smaller operators. However, there are many examples of small entry and the majority of operators did not consider that this limited their ability to compete. We therefore did not find that the overall effect of regulation has an AEC.

**Local policy implementation**

12.80 We now turn to policy implementation at the local (ie LTA) level. As set out above, LTAs have been given increasing discretion to develop plans specific to their area and have the discretion to introduce a range of policy interventions. These include introducing schemes such as voluntary or statutory partnerships, and wider transport


\(^{29}\) Go-Ahead told us that the local highway authority could request that the Traffic Commissioner limited the number of buses in a defined area on safety and congestion grounds.

\(^{30}\) Go-Ahead told us that this was imposed by local highway authorities over defined areas and required buses with lower emission.
policies including bus prioritization. LTA procurement of tendered services is discussed in Section 13 and the local administration of concessionary travel schemes in England is discussed in Appendix 12.3, paragraphs 14 to 25.

**Competition Test**

12.81 We set out in Appendix 12.1, Annex B, details of the Competition Test and associated guidance from the OFT. This applies to certain activities of LTAs including agreements with operators and possible conditions attached to the use of particular facilities by LTAs under statutory schemes. In the reference area, the Competition Test applies instead of the provisions of the 1998 Act and helps to give both operators and LTAs certainty that they are complying with relevant competition rules and removes the risks of punitive action under the 1998 Act.

12.82 The test has two parts requires LTAs to consider any impact on competition as a result of the relevant scheme or agreement. If there is an impact on competition, then this must be for a specified purpose, for example to secure improvements in local bus services. The impact on competition must also be deemed proportionate to the purpose for which it is undertaken.

12.83 The Competition Test is designed to ensure that where a scheme is considered to have a significant adverse effect on competition or is likely to have such an effect, it is justified on the grounds that it delivers benefits to users of local bus services through specified improvements and the adverse effect is proportionate to the achievement of the justification. To that end, we recognize that the Competition Test permits schemes which adversely affect competition subject to the conditions of justification and proportionality being met. In terms of the practical application of the Competition Test, we have not received any substantiated concerns about this during the course of our investigation. We detail in the sections below some of the potential risks to competition that need to be considered in the application of the Competition Test.

12.84 We now look at each of the types of scheme including the role of the Competition Test in this context.

**Partnerships and schemes**

12.85 As set out in paragraph 2.75, LTAs can enter into voluntary and statutory arrangements with local bus operators. Appendix 12.1 also sets out the differences between the legislation in the nations in the reference areas. LTAs are given discretion as to whether they consider it appropriate to make use of these measures.

12.86 We asked LTAs about the partnerships with which they were involved and received survey responses from 91. These illustrated that there were very few statutory quality partnerships in existence, but many more under consideration. In addition we looked in more depth at specific partnership schemes in existence in Nottingham, Merseyside and Chester and a description of these schemes is given as Appendix 12.2.

**Voluntary agreements**

12.87 In our survey of LTAs (see paragraph 12.86), we were given details of 198 voluntary partnerships in existence with 31 under consideration. In our sample, 70 per cent of the LTAs told us that they were involved in these types of schemes.
12.88 LTAs make a variety of commitments under voluntary agreements which can often be described as voluntary partnership schemes. These commitments most commonly include infrastructure improvements such as raised kerbs and bus stops, information improvement, and bus prioritization measures. In addition, one or more bus operators agree to a variety of measures to improve the provision of local bus services, including use of low-floor buses, undertaking driver training, operating higher frequency services, deploying new vehicles on the route, etc.

12.89 There are a broad range of voluntary schemes, with agreements ranging from regional schemes to those covering specific corridors, routes and bus stations. On average, for the schemes we examined there were 1.7 operators per scheme, with each scheme having an average of 1.1 participants from the five Large Operators and 0.6 other operators. In 86 per cent of cases, one of the five Large Operators was a party to the scheme.

12.90 LTAs told us that these schemes often delivered increased investment in services, higher vehicle quality, better punctuality and higher patronage. Based on evidence submitted to us by operators, those who participated in these schemes were generally enthusiastic about them, where the aims of the operator and LTA were aligned; we were given examples of improvements in infrastructure and frequency resulting in significant improvements in customer numbers.

12.91 There was some limited concern expressed about these schemes. ALBUM was concerned that operators may ‘merely pay lip service to the concept, while not in fact acting in the spirit of the partnership … or by attempting to have a partnership designed principally to foster its own aims of market domination’\(^3\) The Big Lemon in Brighton claimed that the Council had refused it entry to the quality partnership scheme on the grounds that it was a private agreement. Brighton and Hove Council has said that it has taken a number of measures to ensure that The Big Lemon is afforded fair and reasonable access to bus infrastructure. The Council told us that the real time information system is accessible to any operator provided it pays for the on bus equipment and any back office equipment.\(^3\) In contrast, there was much support for the schemes from Large operators. For example, Stagecoach and National Express emphasized the growing importance of such informal arrangements and of working in partnership with the LTA. FirstGroup told us that ‘we have many examples of successful voluntary partnerships at all of our operating companies’.

12.92 LTAs are likely to prioritize their resources to those parts of the area where the effect will be greatest—for example, main corridors. It is often the case that Large Operators are present on these routes and so benefit from these schemes, and the high concentration of the local bus market means that it is more likely that the largest operator in an area is a participant in these schemes. However, these voluntary schemes are open to any operator and no operator is excluded from these routes. Therefore there is no evidence of competition being distorted between operators on a route. Some operators in an area might benefit more than others not involved in a scheme. However, we have no evidence to suggest that this, in practice, has distorted competition.

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\(^3\) The ALBUM written submission can be found at: www.competition-commission.org.uk/inquiries/ref2010/localbus/pdf/album.pdf; see paragraph 11.

\(^3\) Submissions on this matter can be found at www.competition-commission.org.uk/inquiries/ref2010/localbus/main_party_submissions.htm.
12.93 Under statutory quality partnerships, LTAs and operators both commit to delivering specific improvements to the quality of bus services in an area or along a corridor. Typically the LTA invests in better infrastructure such as bus lanes, and bus operators invest in better buses or service improvements. Statutory schemes differ from voluntary agreements in that operators which do not participate in a statutory scheme are not allowed to use the scheme facilities. In England, for example, the 2008 Act gives LTAs the ability to restrict the registration or withdrawal of services in a scheme area. However, a statutory quality partnership scheme must be open to all operators which meet the required quality standards.

12.94 SYPTTE told us about the scheme introduced in north Sheffield in 2007 which was designed to improve the quality of services. This involved all operators running in the scheme area, including FirstGroup and Stagecoach, which had to meet certain standards of service and quality of buses to use the prescribed facilities. SYPTTE in conjunction with Sheffield City Council provided facilities such as bus stops, bus lanes and bus detection and priorities at junctions. It told us that it did not receive any formal objections to the scheme and considered that this complied with the OFT Competition Test.

12.95 We also heard from SPT about its experience working with Renfrewshire Council and Glasgow City Council in developing statutory schemes in Renfrewshire and Glasgow, as efforts to achieve quality standards through voluntary arrangements had not been successful. In this Renfrewshire case SPT told us that there had been objections from smaller operators in the centre of Paisley as they would not be able to operate there unless they met the quality standards. SPT told us that it had considered the costs to operators of making the necessary upgrades to low-floor buses and improving emission standards. It told us that these were relatively small and did not outweigh the benefits to customers and the amount of investment it was making in infrastructure improvements. Given this, SPT believed that the scheme was as a minimum appropriate and had addressed the concerns of operators.

12.96 We have also been told about some more general concerns about these types of schemes. Arriva told us that:

(a) many local authorities made a case to the DfT that they need to be able to limit the impact of competition on the provision of commercial services that are subject to substantial investment as part of a Quality Partnership Scheme. Arriva did not make this case to the DfT. Arriva has invested heavily in areas of both low and high levels of competition from other bus operators and does not generally see a need to close areas to competition from other companies; and

(b) it told us that it believed that the threshold that LTAs had to satisfy to justify these schemes was too low. EYMS thought that these schemes might limit on the road competition as it might be difficult for operators to meet the standards. In contrast, Cardiff Bus told us that it was appropriate that where there was competition a minimum standard was set.

Qualifying agreements

12.97 Qualifying agreements are an agreement between bus operators (defined in paragraph 17(4)(a) of Schedule 10 to the 2000 Act as a ‘qualifying agreement’), which may arise through bilateral discussions or as pursuant to the requirements of a quality partnership scheme where, depending on the local circumstances, cooperation might be in the interests of both operators and passengers. An example might
be an agreement about service timings in order to allow compliance with the terms of a quality partnership scheme which includes requirements about frequencies or timings on a route where services are provided by two or more operators. LTAs are not formal parties to this kind of agreement. The consequences of such agreements could be, for example, to agree scheduling between operators either to reduce the competitive intensity between them or to ensure that no gaps are left in services that could facilitate entry by another operator. However, LTAs may certify that the agreement was in the public interest and did not include unnecessary restrictions on competition. In this case, the agreement would fall within the scope of the Part 2 Competition Test.

Impact of partnerships and qualifying agreements on competition

12.98 In paragraphs 15.371 to 15.420 we describe the ways in which well designed partnerships can facilitate competition in local bus markets by:

(a) improving the provision of information to passengers;

(b) growing passenger demand; and

(c) promoting sustained competition.

12.99 However, as anticipated when the Competition Test was introduced, the potential also exists for partnership arrangements to have the following detrimental effects on competition:

(a) First, there is a risk that partnerships have the potential to increase barriers to entry and thereby restrict competition if they specify unnecessarily high quality standards, or specify quality standards in an inflexible way (for example, being excessively specific about the fleet that needs to be used to satisfy the terms of a partnership). This is a particular risk in relation to statutory arrangements where these have the capacity to exclude operators from a route or from particular facilities (see paragraph 12.93). Such specifications may cause operators running a ‘no-frills’ services with lower fares to be shut out of the market, to the detriment of passengers who value low fares highly (although we recognized that high standards may result in benefits for passengers who value higher quality services). Very prescriptive partnership specifications may prevent operators from choosing their service specification in the most efficient way, if they are constrained to meet certain pre-determined criteria. This is likely to be a particular issue for smaller operators, as they are likely to be more constrained financially and are less likely to have the option of reallocating fleet from their other operations. Upper limits on corridor frequencies and bus stop use may also make it more difficult for new operators to enter a route.

(b) Second, there is a risk that a partnership that tightly specifies aspects of participating operators’ service (for example timetable, vehicle and driver quality or ticket types) may constrain the scope for operators to compete for passengers by improving their offering. For example, as we discussed in paragraphs 8.41 to 8.48 rivalry between operators in local bus markets will often take the form of competition on frequency, with operators increasing their service frequency in order to win more passengers. Where partnership agreements have been introduced, they can have the effect of limiting frequency in very high demand areas (see, for example, the schemes in Nottingham, Merseyside and Chester set out in Appendix 12.2). Agreeing to a common timetable on a route can reduce the incentive and/or ability for operators to compete on frequency. While such restrictions might sometimes be desirable—for example, in order to reduce traffic
congestion in busy city centres, or to deliver more even service frequencies—there is a risk that such restrictions reduce the options available to operators to improve their services in order to win passengers from their rivals, and so dampen competitive pressures.

(c) Third, partnerships may increase the likelihood of an anti-competitive coordinated outcome being reached between operators (see Appendix 8.5, paragraphs 52 to 58 for a description of this risk and the specific example of where this was tried). In particular, partnerships may provide an opportunity for operators to meet and exchange information about competitive issues (thereby increasing transparency between operators) and also reduce the number of variables on which operators are competing (thereby making it easier to identify and reach a coordinated outcome). We considered that this risk was likely to be particularly acute in the context of qualifying agreements, (see paragraph 12.97) given the reduced role that the LTA plays in these agreements relative to voluntary and statutory partnerships.

12.100 As mentioned above partnership schemes are subject to the Competition Test (see Appendix 12.1, Annex B) and we note that in England there is guidance from the DfT on the introduction of these Statutory Partnership schemes. This stresses that the 2008 Act provides important safeguards to ensure that unrealistic conditions are not imposed on operators and that the legitimate right to a fair commercial rate of return on their investment is not undermined. Similar guidance on statutory quality partnership schemes has been issued by the Welsh Government and Scottish Government.

12.101 In making our overall assessment of partnerships, we are mindful of the limited evidence base in relation to statutory partnerships in particular. In addition, we note the scope for concerns relating to possible restrictions on competition to be considered within the Competition Test (see paragraphs 12.81 to 12.83) and the fact that operators have the right to make formal complaints about any scheme. In light of the safeguards that are in place, and in the absence of evidence of specific distortions of competition, we do not find that the ability to introduce these schemes adversely affects competition.

12.102 Nonetheless, we are acutely aware of the risks of misuse of partnerships. In particular, it is important for LTAs to ensure that efforts are taken such that partnerships do not unnecessarily exclude operators or deter entry, do not unnecessarily constrain the scope for operators to improve their service offering and do not facilitate coordination that goes beyond what is acceptable under competition law and what is required to deliver benefits to passengers. There is a risk of an unwarranted restriction to competition that goes beyond what is necessary to deliver passenger benefits. This could occur if LTAs do not give each of the potential detrimental effects of partnerships full consideration when they are considering introducing a partnership scheme and applying the Competition Test, and in particular do not give sufficient recognition to the negative impact that a partnership scheme may have on the public interest if that scheme dampens incentives for the operators in an area to compete for passengers. With this in mind in the section on Remedies we make a recommendation that a forum is set up by the OFT at which the practical application of the Competition Test can be discussed with stakeholders (see paragraphs 15.410 to 15.413).

Quality contract schemes

12.103 Quality contract schemes are outlined in Appendix 12.1, paragraphs 79 to 84. Quality contracts allow LTAs to determine the routes, fares, quality standards and frequency
of bus services in specified areas by making a scheme. After the scheme has been made, a quality contract is put out to tender and the successful bus operator gains exclusive rights to provide services to the LTA’s specification, and other operators would no longer be able to register any commercial service within the quality contract area.

12.104 No quality contacts are yet in existence, although we are aware that Metro in West Yorkshire, for example, intends to start consulting on a scheme. The original intention was that quality contract schemes should only be introduced in exceptional circumstances where there was no practical alternative. The 2008 Act requires that in England and Wales the LTA must be satisfied that the scheme satisfies public interest criteria as set out in Appendix 12.1, paragraph 80, relating to the achievement of benefits in transport provision and implementation of local transport policies while being efficient and effective and not imposing disproportionate adverse effects on bus operators.

12.105 The 2008 Act removes the requirement for the Secretary of State in England to approve a quality contract, although the Welsh Ministers must approve quality contracts in Wales. In England, LTAs must refer any proposed scheme to an independent Quality Contracts Board for consideration. The Board will make and publish its views as to whether the scheme meets the public interest criteria, together with any recommendations. However, the LTA makes the final decision on scheme implementation. Scotland introduced the ability to make quality contracts in the Transport (Scotland) Act 2001. These are substantively the same as the schemes in England prior to the changes made in the 2008 Act.

12.106 As there are no Quality Contract schemes in operation, we have no reason to conclude that scope for introducing such schemes gives rise to an AEC. In paragraphs 15.432 to 15.469 we consider the use of Franchising, within the Quality Contract Scheme legislation as a remedy option.

**Other aspects of local transport policy**

12.107 Other aspects of policy include provision of bus priority such as bus lanes, car-parking policies, provision of information, provision of park-and-ride schemes and so on. We noted that bus operators, particularly Large Operators, tended to regard relations with LTAs and lobbying for the promotion of local bus measures within local transport policy as extremely important.

12.108 We now highlight some more general comments from operators about the impact of local policy.

12.109 Arriva told us that local transport policy had a strong impact on whether an area was an attractive place to operate. This was especially true where there was a heavy reliance on the car. Actions that could be taken include bus priority measures, parking controls, provision of infrastructure and joint marketing and promotion of services. It believed that this might increase demand for bus services. Arriva told us that it had changed its business structure to develop even closer links between operating companies and local authorities, in part to help develop local transport policy in partnership with LTAs.

12.110 FirstGroup also said that policy could have a strong influence on bus demand and the attractiveness of an area. It cited a wide range of areas:

- provision of bus priority—LTAs were said by FirstGroup to have a lot of control over the allocation of highway space. It said that good examples were: Swansea
bus-only track bus lanes and bus gates; and guided busways in Leeds and Bradford. This was in contrast to, say, Southampton where buses were given relatively little priority; or Aberdeen where the priority system was not effective; and Stirling where bus priority measures were being removed;

- policies on car-parking availability and charges which vary widely between LTAs;
- a range of schemes and partnerships;
- provision, management and maintenance of the road network;
- park-and-ride infrastructure and dedicated bus services;
- provision of information to bus users;
- provision and management of bus stations;
- terms of concessionary fare reimbursement;
- tendering of socially necessary services; and
- planning policy and location of new developments.

12.111 Go-Ahead contrasted the level of spend by Nexus with little spend in County Durham/Northumberland and insufficient progress there on infrastructure of any scale to make any difference. However, it told us that competition was more to do with market opportunity than LTA intervention.

12.112 Stagecoach said that ‘local transport policy has a significant effect upon whether an area is an attractive place to operate bus services’.

12.113 EYMS told us that policy had an impact on the attractiveness of an area. It characterized York as ‘good’ and East Riding as not so good in policy terms. It believed that this was reflected in the level of competition in these areas.

12.114 Three quarters of small operators told us that local or national transport regulation had no impact on their ability to compete. Only four per cent thought it did to a large whilst 15 per cent thought it did to some extent.

12.115 Local transport policy may be driven by a range of objectives including a desire to increase access to areas to encourage economic activity, for social inclusion and for environmental purposes—eg to reduce congestion and pollution. Different authorities may take different views on the extent to which local bus operations should be promoted in order to pursue various objectives. Different aspects of policy may fall to different local authorities, for example LTAs may have different objectives to those of highway authorities, while councils may have various priorities relating to car parking including revenue raising, promoting retailers in town centres or providing choice and convenience to the public, which could be in conflict with measures to encourage bus use over private cars.

12.116 We recognize that local policy can have a significant impact on conditions in the local bus market and that there are variations between areas. Decisions may affect the allocation of road space to local buses or the amount of local expenditure. In addition, LTAs may set up schemes to promote local bus and to develop patronage. We conclude that all of these measures are important and influence the attractiveness of an area for a bus operator.
12.117 We consider that there is a potential role for LTAs in encouraging local competition. We discuss the ways in which this might be achieved in Section 15 in the context of our recommendation that LTAs consider the potential of partnerships to facilitate competition (see paragraphs 15.371 to 15.420).

Ticketing schemes

12.118 Local authorities can set up statutory bus ticketing schemes which can require all operators of local bus services in the area to provide integrated ticketing. The types of tickets that may be covered by a ticketing scheme include: multi-journey tickets; through tickets entitling the holder to make a particular journey using two or more local services (whether or not they are run by the same operator); ‘multi-operator individual tickets’; and tickets for connecting local bus and rail or tram services. These different ticket types are described in Appendix 6.7.

12.119 A statutory ticketing scheme has to satisfy the Part 1 Competition Test (see Appendix 12.1, Annex B). Alternatively a ticketing scheme may be part of an arrangement under the block exemption (see Appendix 12.1, Annex A). Ticketing schemes were introduced in Scotland through the Transport Act (Scotland) 2001.

12.120 We received no evidence to suggest that such ticketing schemes prevent, restrict or distort competition. Tickets issued under such schemes tend to be used fairly infrequently but they provide a means of offering alternative ticketing arrangements which can increase consumer options.

12.121 We set out in paragraphs 15.11 to 15.109 our recommendations for legislative changes to give LTAs additional powers to introduce ticketing schemes and to have more influence over the characteristics of these schemes.

Concessionary travel schemes

12.122 In Appendix 12.3, we review the way in which bus operators are reimbursed through the concessionary travel schemes, and assess whether the approach to reimbursement has any distortionary effects on competition which could be avoided through a different, more effective, approach. This assessment in Appendix 12.3 is structured as follows:

(a) First, we look at the level of expenditure on concessionary travel and the principles through which operators should be reimbursed for carrying concessionary passengers (see paragraphs 3 to 12).

(b) Second, we look at the variations in the way in which the nations in the reference area administer the schemes and approach the calculation of the level of reimbursement (see paragraphs 13 to 36).

(c) Third, we consider the evidence and views we have received about the impact of concessionary travel reimbursement on competition and identify the possible distortions (see paragraphs 37 to 67).

(d) Fourth, we assess whether in practice there are such distortions to competition in any of the nations and conclude on whether we find an AEC (see paragraphs 68 to 101).

12.123 Based on this assessment, we have identified certain circumstances in which the arrangements for the administration of reimbursement payments under the
concessionary travel scheme may distort competition. However, we are satisfied that there are adequate mechanisms to avoid this—in particular, new guidance to LTAs in England and controls on fare levels used for reimbursement in Scotland and Wales. We find that the arrangements for the administration of reimbursement to operators for the concessionary travel schemes in the reference area does not in practice result in a prevention, restriction or distortion to competition. This finding relies, however, on the new guidance being taken up in England and the continued application of the controls on fare levels used for reimbursement in Scotland and Wales. As a result, we urge these governments to ensure that the guidance and controls are followed.

**Conclusions**

12.124 We have considered whether the design of policy and regulation has adverse impacts on the process of competition between local bus operators, or changes the nature of competition between them and market outcomes such that there are adverse consequences to passengers and taxpayers through, for example, higher prices, poorer quality of service or higher public costs.

12.125 In general, we have found that these interventions in the market have not had any adverse impact. We are conscious that schemes to pursue policy objectives are likely always to apply, and we have not attempted to compare different possible policies or comment on policy design, as we are evaluating the competitive effects of current policy and regulation.

12.126 We have identified a number of potential future risks to effective competition including the way in which the Competition Test is applied in schemes such as partnerships and the approach and priority given to competition enforcement in the Local Bus Market. We have also emphasised the need for LTAs in England to follow guidance on Concessionary Fares reimbursement and for the governments in Scotland and Wales to continue to apply controls on fares used in reimbursement.

12.127 In Section 15 we outline our recommendations for the ways in which changes to the policy and regulation framework can be used to deliver remedies to address the AEC. We also set out the way in which the risks we have identified can be addressed or mitigated for example through a forum on the Competition Test (see paragraphs 15.410 to 15.413).
13. Competition in the tendering of supported services

Background to supported services

13.1 As outlined in paragraph 2.76, LTAs have a duty\(^1\) to secure the provision of public transport services where they consider it appropriate and the services would not otherwise be provided.\(^2\) It is for the LTA to formulate policies to allow it to determine the level of services it considers to be appropriate, taking account of its objectives. A need to secure such services may be identified, for example, if existing commercial services are considered not to meet social needs or provide adequate services to rural areas. Different types of services may be procured: scheduled services; services to transport schoolchildren and students; and demand-responsive services. Contracts relating to park-and-ride services are more likely to be motivated by a desire to reduce congestion and for environmental benefits, or to stimulate economic activity in town centres.

13.2 Services can be procured for a whole route or for part of a route, and similarly for the whole of the timetable or just certain days or times of day (for example, Sundays or late evenings).

13.3 Where authorities are procuring such services, they are generally required to invite competitive tenders from operators.\(^3\) This is to enable authorities to award the contract to the most economically advantageous tender and to achieve best value.\(^4\) Any bus operator can be eligible to bid for a contract provided it has the appropriate licence and resources to operate the service. In this section, we are mainly concerned with competition in the market for the tendering of supported services. We use the term tendered services to refer to these services procured by LTAs. In some cases, including de minimis and emergency service provision, a tender process may not be completed for these supported services.

13.4 A contract for a tendered service usually specifies the detail of the service including the route and timetable, and may specify fares to be charged. In addition, the type of vehicle to be used, its capacity, accessibility, engine rating etc are increasingly specified in the contract. Tenders may cover the operation of more than one service, and more than one contract may be tendered at one time allowing operators to bid for ‘bundled contracts’. This may allow an operator to develop a significant scale of supported operations and to make more effective use of vehicles and drivers. Most contracts contain clauses that allow them to be suspended if another operator decides to register the same service and to run it commercially.

13.5 An important distinguishing feature in the contract is which party receives the revenue from operating the service and so takes the revenue risk in the contract. There are two main approaches:

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\(^1\) Under the 1985 Act (sections 57 and 63), LTAs have a duty, and non-metropolitan district councils have power, to secure the provision of public transport services that they consider appropriate to meet social needs and that would not otherwise be available. The 2008 Act has widened the criteria to include the ability to support services which would otherwise not be provided to a particular standard which includes frequency or timing of service, days or time of day operating or the vehicles used.

\(^2\) Procured services may be referred to as tendered services or supported services. The service is supported in the sense that it would not otherwise be provided commercially, but these contracts are not intended to provide any financial support to bus operators other than payment for the provision of the service.

\(^3\) Local authorities must generally invite competitive tenders for any contract (1985 Act, section 89); these contracts can run for up to eight years. There are exceptions for up to three months where action is urgently required for the purpose of: maintaining an existing service; securing a service which has ceased to exist; or securing a service to meet a public transport requirement which has arisen unexpectedly and ought to be met without delay. There is also a de minimis level below which a tender is not required or the processes which need to be followed, if tendering, can be relaxed.

\(^4\) In deciding which tender to accept, local authorities must have regard to a combination of economy, efficiency and effectiveness; the implementation of the policies set out in the bus strategy; and the reduction or limitation of traffic congestion, noise or air pollution (1985 Act, section 89).
• cost-based (often known as minimum-cost): the LTA receives the revenue from passengers and the operator tenders for the whole cost of running the service (ie the revenue risk is taken by the authority); and

• subsidy-based (often known as minimum-subsidy): the operator retains the revenue from passengers and tenders for the cost of operating the service less the estimated revenue (ie the revenue risk is taken by the operator). In producing a bid, the operator will have estimated the likely amount of revenue.

13.6 There are regulations\(^5\) which require authorities to publish information about the tender process. In England and Wales, the regulations require authorities to publish the following information:

- the name of the successful tenderer;
- the amount of the successful tender;
- the number of tenders received; and
- the amount of the highest and lowest tender (for each basis on which the tender was invited).

13.7 The Scottish Regulations\(^6\) set out procedures that, in the main, Scottish public bodies (including local authorities) need to follow when awarding contracts for goods, services and works. A requirement of the Scottish regulations is that public bodies apply a standstill period between the decision and the award of the contract. This gives tenderers 'sufficient time to examine the contract award decision and to assess whether it is appropriate to initiate a review procedure'. At the start of the standstill period (normally ten days) a notice is sent in writing to all parties involved in the competition. During this period, bidders have the opportunity to challenge the contract award decision. The notification in writing (known as 'standstill letter') of the contract award decision must contain the information listed below:

- contract award criteria;
- where practicable, the score obtained by the tenderer and the successful tenderer;
- the name of the successful tenderer;
- (unsuccessful recipients only) a summary of the reasons why the tenderer or candidate was unsuccessful;
- (unsuccessful tenderers only, not candidates\(^7\)) the characteristics and relative advantages of the successful tender; and
- a precise statement as to the effect of the standstill period on the recipient’s rights.

\(^5\) These are the Service Subsidy Tendering Agreements in England 2002 and 2004. In Wales, it is the Service Subsidy Agreements (tendering) (Amendment) (Wales) Regulations 2002 as amended.

\(^6\) The Scottish regulations (The Public Contracts (Scotland) Regulations 2006 (SSI 2006 No 1), as amended (‘Scottish Regulations’)—www.scotland.gov.uk/Topics/Government/Procurement/Selling/10615)—implement EU Procurement Directives in Scots law (procurement is a devolved matter to Scottish Ministers).

\(^7\) Candidates are participants in the pre-qualification stage (this selects who is suitable and capable to be invited to tender) that may or may not go on to become ‘tenderers’.
13.8 The operation of supported services is subject to Part 1 of the Competition Test (see Appendix 12.1, Annex B). This is designed to ensure that authorities take account of the impact, for example, of either long tender periods or a bundling of service contracts on the ability of companies to compete for a tender. Long contracts may foreclose companies from the market and bundled contracts may mean that smaller operators are unable to meet the requirements of the contract.

13.9 Many supported services are also provided for pupils. Under the Education Act 1996 in England and the Learner Travel (Wales) Measures 2008 in Wales, local authorities can secure the provision of school buses to meet their duty to provide free transport to certain pupils based on their distance from school, whether they might have a dangerous journey or if they have special needs. Nearly 20 per cent\(^5\) in England and 24 per cent in Wales\(^6\) of the school population qualifies for free transport nationally. The relevant authority has the choice of contracting out services, providing free passes or financial support or operating their own buses. Figures from the DfT\(^7\) indicate that 60 per cent of school bus provision is provided on contracted services and 37 per cent of pupils receive free passes or financial support with only minimal authority-operated services. In Wales, just over 11 per cent of pupils and students whose transport was funded or provided by local authorities travel on a local bus. In Scotland, in practice all authorities provide free transport for pupils living more than the statutory walking distance from, and attending, the school the authority has identified as the nearest suitable school.\(^8\)

13.10 As set out in Appendix 13.1, mid-tier operators told us that, typically, bids for tendered services were based on a margin over costs, in order to achieve an acceptable return (see Appendix 13.1, paragraph 132). Most operators told us that an important factor in the decision to bid would be the extent to which the service could be run using existing assets (for example, an off-peak tender could be run with buses currently also used for peak commercial services) and the distance from an existing depot to the supported service (see Appendix 13.1, paragraph 126). We were told that longer-term contracts and large contracts (such as a bundle of services or a park-and-ride service) may also be seen as particularly attractive to operators, and the pricing of bids for such contracts may reflect this (see Appendix 13.1, paragraphs 127 and 128). These larger contracts might also provide a means for an operator of entering a new area or expanding a business. Large contracts carry an associated risk if they are not renewed or if the operator does not win a retender, as an operator could be left with costs if it cannot find alternative business. However, these large contracts can be a means of reducing risks for a period when seeking to begin commercial operations in an area on a substantial scale, as described in paragraph 6.78.

13.11 In the financial year ended 2010, local authorities in England and Wales (excluding London) spent £462 million\(^9\) in net public transport support of which the bulk accounts for spend on supported services.\(^10\) Supported services represented 23 per cent of the total mileage (by distance operated) of all local bus services in the reference area in 2010/11 (see Table 2.3). The average payment by LTAs to bus oper-

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\(^7\) DfT, ibid.
\(^8\) The statutory walking distance is defined as 2 miles for children aged under 8 and 3 miles for those aged 8 or older.
\(^10\) The figures also include administration costs and inter-authority transfers and some support for non-local services, meaning that a small proportion will not reach local bus operators.
ators per kilometre was £0.90. There was substantial variability in the level of expenditure on supported services by absolute amount and in relation to kilometres operated across the countries and areas of the UK. Supported services are funded by LTAs drawing on local government funds and so there is no specific allocated budget for tendered services. Therefore, LTAs will need to determine what level of support for such services is appropriate in the light of their overall budgets. Several local authorities indicated during the course of this investigation that funding of such services could be substantially reduced in the near future.

13.12 ATCO undertook a survey of English councils (ie LTAs) in February 2011, asking for details of their strategies in relation to supported services in the light of the spending review. Many councils spoke of the need to reduce tendered services, either focusing support on key services or making across-the-board cuts and increasing fares on tendered services. Some councils, including Cambridgeshire CC and Hartlepool, said that they intended to withdraw completely from supporting bus services. For 2011/12, the survey reported that around 30 per cent of shire and unitary authorities planned cuts in support of 25 to 50 per cent, and around one-third of unitary authorities planned cuts of over 50 per cent. For 2012/13, over one-third of shire authorities and about half of unitary authorities planned cuts of over 50 per cent. All PTEs reported intended cuts of less than 25 per cent in both years.

13.13 The House of Commons Transport Committee Report Bus Services after the Spending Review states that: ‘As a result of these budgetary pressures, over 70 per cent of local authorities have already decided to reduce funding for supported bus services. The extent of the reductions varies considerably, although, in general, rural, evening and Sunday bus services will be most affected. In the most extreme cases, some local authorities have decided to withdraw all their subsidised bus services.’ The 70 per cent figure is attributed to the Campaign for Better Transport, Save Our Buses Campaign, June 2011, www.bettertransport.org.uk, sourced primarily through local authority minutes and press notices. Passenger Focus provided evidence to the select committee cataloguing £43.5 million of cuts being made by 42 of England’s 88 LTAs to their local bus services in 2011/12.

13.14 In its reasons for making a market investigation reference to the CC, the OFT indicated some concerns about competition in the market for the tendering of supported services. It found that the cost of tendered bus services had increased over the last ten years, by a greater proportion than available indices of bus operator costs. It noted that in some areas the number of bids for tendered services was low, which might be linked to the willingness of small operators to bid, and to market structure. It proposed that markets which had a small number of operators would struggle to achieve high numbers of bids as distance from the operating area was a key factor in the competitiveness of a bid. There were concerns that operators might attempt to withdraw services which were commercially viable in the hope of attracting support from LTAs; and it found a positive correlation between the number of commercial services withdrawn and the number of contracts receiving one bid, although it acknowledged that it was uncertain how this link should be interpreted. It also found that LTAs appeared to play a significant role in the functioning of the market, for example it considered that the manner in which LTAs managed

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14 The mileage and spend per kilometre figures are CC calculations based on 2007 data.  
17 See footnote 18 to www.publications.parliament.uk/pa/cm201012/cmselect/cmtran/750/75006.htm#note18.  
18 Passenger Focus response to Provisional Findings, p9.  
competition for their contracts had a material effect on the number of bids they received.

13.15 The OFT concluded (see paragraph 4.157 of its report) that in its view, these features might combine to prevent, restrict or distort competition. It said that the low number of bids for many contracts was indicative of the adverse effect this feature was having on competition in local bus markets.

13.16 We now consider aspects of competition in the market for the tendering of supported services and our analysis of issues which have been raised as possible impediments to effective competition.

**Approach to analysis**

13.17 We found that there are separate relevant markets for the operation of local bus services, and for the tendering of supported services. In this section, we address competition in the tendering process. Within the market for the operation of bus services, there is unlikely to be significant overlap of supported services with commercial services, as otherwise there would be no need for an LTA to procure the supported services. Where supported and commercial services overlap, this is included in our evaluation of competition in the provision of local bus services—see Section 11.

13.18 We also recognize that there is often an interaction between commercial and supported services; many operators will offer both commercial and supported services, and each type of service can provide a basis for expansion into the other type of service. In this section, our interest is in the market for the tendering of services, ie the competition is for the market via the tender itself rather than within the market.

13.19 In order to explore issues in relation to competition in the tendering of supported services, we have sought the views of parties involved in the market and have gathered a broad base of quantitative information about the operation of tendered services from LTAs and operators. As detailed in Appendix 13.1, we sent questionnaires to all LTAs asking a range of detailed questions about their activities. The topics included the circumstances in which LTAs provide support for local bus services and how they organize the tender process and evaluate the results. We received responses from 91 LTAs, covering over two-thirds of all 132 LTAs in the reference area, with a good representation from LTAs in Wales and Scotland, from all the PTEs in England and from a range of other urban and rural areas in England. We also held hearings with a number of LTAs. We sent written questions to all operators about tendered services and the role and impact of LTAs on the market. We received responses from all the Large and Mid-Sized Operators and from nearly 200 Small Operators. We also held hearings with various operators, public sector bodies and trade associations and other representative bodies. This information has provided us with a great deal of evidence on the operation of the market for tendering of supported services, perceptions and concerns within the market.

13.20 We gathered a data set of tendered contracts from LTAs which could then be used as a basis for a quantitative analysis of the market for tendering supported services. As detailed in Appendix 13.2, 75 LTAs provided data on contracts for supported bus services which they had put out to tender in the past five years, and the bids that they had received for these contracts. For each tender, information was collected about the characteristics of the contract and the route(s), the identity of all the bidders, and the value of the winning bids and all other bids. The number of observations in the

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This count included one response from Strathclyde Passenger Transport which itself covers ten LTAs in Scotland.

13-5
This resulting bid data set covers a significant number of tenders, a large number of LTAs, and contains data for bids by operators of different sizes. Both rural and urban LTAs are present in our sample, as are the PTEs. We found no indication that those areas which were not covered or those observations which were not usable represented particular types or contract or circumstances of tender which could influence the results from the analysis of this sample. We therefore believe that the data set is representative of tenders for supported bus services.

13.21 The geographic coverage of the bid data is shown in Figure 13.1.

**FIGURE 13.1**

Coverage of the bidding data included in the cleaned data set

Source: CC analysis of LTA responses and Ordnance Survey Boundary-line background mapping.

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21 This excludes observations with incomplete data.
13.22 As set out in Appendix 13.2, we have used this information both to plot a number of descriptive graphs and to undertake an econometric analysis of how different characteristics of the local area, the tender design and the presence of the various operators affect:

(a) the number of bidders in a given tender;

(b) the bidding decision of Main Operators and Small Operators; 22

(c) the likelihood that the incumbent wins;

(d) the likelihood that one of the Main Operators or a Small Operator wins;

(e) the difference between the current and the previous winning bid; and

(f) the value of the winning bid per km.

Prices for tendered contracts

13.23 As highlighted in paragraph 13.14, in its decision to refer local bus services for a market investigation, the OFT expressed concern that the cost of like-for-like contracts was increasing above the rate of increase of bus operator costs. We have not undertaken a similar exercise because in many cases contracts were not renewed on a like-for-like basis. We also noted that there are many difficulties in constructing an appropriate operator cost index, available information on operator costs is limited, and the necessary information to develop a robust cost index was not available. However, we have looked at changes in tender prices and sought to determine the reasons for differences in rates of cost increase through gathering evidence from parties and undertaking a quantitative analysis—see Appendix 13.2, Analysis 5.

13.24 We asked LTAs about their experience of movements in tender prices on renewal over the past three years, and about the main reasons for the increases that they had experienced. Table 13.1 summarizes the assessment by LTAs 23 of movements in the price of contracts.

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22 For the purposes of the analysis in Appendix 13.2, the ‘Main operators’ are Arriva, Choice Travel, EYMS, FirstGroup, Go-Ahead, National Express, Rotala, Stagecoach, Veolia and Western Greyhound. The remaining operators are classified as ‘Small’. References to ‘Main Operators’ and ‘Small Operators’ in this section refer to these operators. See also paragraph 10 of Appendix 13.2.

23 Fifty-three LTAs (59 per cent of those responding) provided this information. The LTAs that did not complete this analysis told us that it was too difficult to do or would be too time-consuming. Those that did often added caveats and quoted a number of reasons for price increases with no allocation of tender numbers. In these cases, the total tenders have been pro-rated across the reasons given, except where the reason was stated as not known.
TABLE 13.1  Movements in tender prices for re-tenders during the last three years

<table>
<thead>
<tr>
<th>Number of LTAs providing information</th>
<th>54</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of contracts re-tendered during the past three years</td>
<td>2,648</td>
</tr>
<tr>
<td>Number of contracts in which price decreased</td>
<td>815</td>
</tr>
<tr>
<td>Number of contracts in which price stayed the same</td>
<td>478</td>
</tr>
<tr>
<td>Number of contracts in which price increased</td>
<td>1,355</td>
</tr>
</tbody>
</table>

For those contracts which increased in price the main reason was:

- Catch-up at contract renewal: 244 | 18
- General increase in costs: 609 | 46
- Traffic congestion reducing vehicle speeds: 33 | 2
- Change in specification (eg additional service, change in vehicle requirement): 130 | 10
- Changes to legislation (eg BSOG, concessionary reimbursement): 41 | 3
- Other: 47 | 4
- Reason not known: 251 | 17

Source: CC analysis of information submitted by LTAs.

13.25 There was no uniform pattern of price increases at re-tender; in 30 per cent of cases prices decreased, and in 18 per cent of cases prices stayed the same. In 51 per cent of cases in the tender sample, prices increased. We noted that price increases seemed more prevalent in Scotland and Wales compared with England (excluding London) and that PTEs had the lowest incidence of price increase.

13.26 Where prices have increased, LTAs were most likely to suggest that the primary cause was a general increase in transport costs, with a catch-up in prices on contract renewal (where the contract indexation was inadequate) or a change in the specification of the service being the other key explanations.

13.27 We also looked at how prices have changed for different types of LTA—see Table 13.2. Whilst some care is required in interpreting these figures, given the relative sample sizes, and because the results are not weighted by size of contract or extent of price change, our analysis does indicate some diversity of experience. In Scotland, 80 per cent of contracts showed an increase in price. In contrast, for the PTEs, this was 31 per cent. A little over half of the contracts of Shire authorities, unitary authorities and Wales showed an increase.

TABLE 13.2  Comparison of tender price movements by LTA

<table>
<thead>
<tr>
<th>Number of contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>PTE %</td>
</tr>
<tr>
<td>Re-tendered total</td>
</tr>
<tr>
<td>Price decreased</td>
</tr>
<tr>
<td>Price stayed the same</td>
</tr>
<tr>
<td>Price increased</td>
</tr>
</tbody>
</table>

Source: CC analysis of LTA responses.

13.28 Given the complexity of all relevant factors at contract renewal (to ensure that we truly compared like-for-like) and the criticisms that have been made about the limitations of the bus-operator cost indices that are available, we did not conclude on whether the average increase in tendered contract prices was indicative of any failure of competition. We also note the wide variety in results for contract price changes. Instead, we explored whether there are any indications of failures in the competitive process for tenders of supported services.
The competitive process for tendered contracts and the importance of the number of bidders

13.29 We now address what we mean by the competitive process in the context of tendered contracts, and how this depends on the number of bidders for a contract.

13.30 Operators compete for the right to service a contract to deliver supported services. The nature of ‘competition’ in the market differs from most markets, where, in a continuing process of rivalry, suppliers adjust their offering in an attempt to attract profitable custom in the light of what their rivals are doing. Under tender arrangements, the competitive process is condensed into a single event, where each operator decides how to form and price its tender bid. In doing this, it will need to take a view on how to trade off the profitability of the contract if it should win against how it specifies its bid in order to increase the likelihood of winning. For example, bidding a lower price or offering a higher specification of vehicles are likely to increase an operator’s chances of winning the contract but are likely to reduce the profitability it will achieve on that contract. Competition therefore arises where a variety of bids are made and operators modify their behaviour in anticipation of the likely behaviour of rivals who are also trying to win the tender in forming their bids.

13.31 The process of competition therefore depends on a number of factors including:

- the ability of different operators to offer different types of bid (eg whether or not they are capable of delivering different qualities of service, their underlying efficiency, whether the particular tender can easily be assimilated into different operators’ existing operations using a minimum of additional resources—for example, because these are already spare at that time of day—or whether it would require additional investment);

- for any operator, its perception of how many other operators are bidding, and the likely nature of their bids, and hence how it must itself bid in order to be likely to win the contract; and

- how eager it is to win the contract and hence how aggressively it will bid for the contract. This will depend on the anticipated profitability of the contract itself, but also other factors such as whether there are any strategic implications (eg in establishing the operator in a new area or stopping a rival from doing so) and whether there are risks and uncertainty attached.

13.32 While each tender event could be regarded as a one-off event, with competition taking place on a case-by-case basis (and so the nature of competition possibly varying between cases), this is a simplistic view as within an area there will be a succession of tenders issued over time. This means that operators will come up against each other repeatedly, they will establish a track record with the LTA, and they will each learn who has won past contracts, the type of bid that is successful and other information (see paragraphs 13.6 and 13.7) including the number of past bidders. Tender contracts will also build into a portfolio of activities in conjunction with commercial services which will alter the perception of the value of a contract to different operators. Contracts may also be re-tendered when they expire where one operator will have had experience of operating them.

13.33 The OFT in its referral document (see paragraph 13.14) indicated concern that in some areas there was a low number of bids for tendered contracts. We now consider whether the number of participants bidding for a tender can affect the process of competition for the tender, with a view to considering whether any features of the
market that impede bids or reduce the number of bidders for a tendered contract might reduce rivalry and so reduce the effectiveness of competition.

13.34 Some of the Large Operators told us that the tendering process would lead to competitive outcomes in the market for tendering supported services, arguing that the number of bidders did not drive this process. Generally, operators will be unaware of who else submits a bid for a particular tender, and the nature of their bid. In consequence, the tender process creates a sealed-bid auction, and it was put to us that in order to expect to win the tender, an operator was forced to bid competitively, so long as the bidder perceived a risk that other operators could also bid.

13.35 Several LTAs thought one bid would be acceptable for this reason (see Appendix 13.1, paragraph 7).

13.36 Some operators also stated that competitive outcomes could be achieved in a tender process regardless of the number of bidders, for example National Express stated that:

it is perfectly possible for a competitive bid involving just two bidders to deliver prices as low as tenders involving ... more than two bidders. It is even plausible that where there is a single bidder under the illusion that it is facing competition in bidding for a tender (as will usually be the case in the West Midlands) it will be forced to submit a bid at the competitive level.

13.37 Arriva referred to the Monopolies and Mergers Commission (MMC) Go-Ahead/OK inquiry, which was said to recognize that the nature of bus tendering meant that any bidder should assume that there would be competition. In that report the MMC stated that ‘Provided that no individual bidder knows how many other bidders there will be, it must bid just as keenly even if, in the event, it turns out to be the only bidder.’ However, the MMC did not accept that the existence of two bidders was sufficient. It stated that ‘it would only take one of these bids to be unsatisfactory, for whatever reason, for the local authority to be left with little choice. We consider that the more tenders received the better.’

13.38 There are, however, reasons to expect that a greater number of bidders may influence the process of competition and produce auction outcomes with lower prices or better quality. Operators are likely to have some idea whether a tender will be attractive to very few, or a great many operators depending on the nature of the particular contract (eg if it is located in an area served by many other operators and whether it can be easily integrated into other commitments), and whether tenders are likely to be attractive to specific local rivals given knowledge of their strategies, their past bidding behaviour and success, their capacity and their existing service commitments. Given that routes are often tendered several times and the results from other similar tenders may be available to operators, it is likely that they will have some expectation, at least in general terms, of the number of possible bidders and the identity of some of them, even though operators will not know how many bids will actually be made. Possible bidders need to make a trade-off in their bid between

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25 Paragraph 2.60.
26 Paragraph 2.61.
27 Arriva argued that our quantitative analyses in Appendix 13.2 were flawed in using the actual number of bids as an explanatory variable when it should be that more potential bids affect the outcome. While operators may face considerable uncertainty in evaluating how many rivals are likely to bid for a service, and may not evaluate this explicitly, in that they need to decide how aggressively to bid for a contract we would still expect to see a correlation between their bidding behaviour and the number of bids actually received.
the probability of winning and the margin they hope to make on a contract. If more bidders are expected, then this trade-off may be altered (eg more bidders mean that they have to accept a lower margin if they are to stand a chance of winning the contract at all).28 This influence on how operators chose to specify their bids is a key aspect of the competitive rivalry we would expect to see.

13.39 Second, an increase in the number of bidders can increase competition because operators differ in a number of characteristics such as tactics and efficiency, and hence how they may choose to specify their tender bid. They may also vary in their expectations (eg of on-bus revenue) and the margins they are willing to accept or the quality of service they are willing to offer. The presence of more bidders increases the variability of bids and therefore provides more choice for the LTA.29 The ability of an LTA to exercise choice between different operators drives beneficial outcomes from the tender process and encourages operators to make competitive bids. However, we find that only a moderate number of operators participate in tenders for local bus services. For the tenders analysed in Appendix 13.2, the average number of bidders is 3.2 and only 1 per cent of the tenders attracts more than ten bidders—see also paragraph 13.42 below.

13.40 Arguments that the number of bidders influences outcomes are set out more formally in economic theory—see, for example, Krishna (2002) for this basic intuition, or Klemperer (2004) which shows that auctions are rarely perfectly contestable such that the number of bidders is not relevant.30,31 In the CC working paper Bidding Markets (2005), Klemperer also sets out reasons why auctions and bidding processes are unlikely to address concerns over market power.32

13.41 LTAs indicated that they usually desired several bids in a tender. Our analysis of information provided by LTAs showed great variability in the numbers of bids for contracts. There were very few bids for certain types of contracts and in certain areas (see Appendix 13.1, Table 2). For example, there were on average fewer bids for tenders in Scotland than the rest of the country, and some areas such as West Yorkshire and Fife averaged fewer than two bids per tender. 12 per cent of contracts across the country received only one bid. Fifteen of the LTAs responding to our questionnaire told us that they thought there was a specific problem with the number

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28 The value of a tender is either the expected cost of running the service (in case of a minimum cost contract) or the net cost, that is the expected cost of running the service net the expected revenue (in case of a minimum subsidy contract). To simplify the explanation, we will refer to both as ‘cost’ below. In a tender, bidders can build a profit margin into their bid by bidding above their cost of running the service(s) (ie the difference between the payment by the LTA and their actual cost). The profit margin cannot be increased too much since otherwise there will likely be another operator who bids lower, ie who offers to run the service(s) for a lower payment by the LTA. A bidder hence trades off the higher profit and the lower probability of winning arising from a higher bid. If more operators participate in a tender, it becomes more likely that there will be another operator which will submit such a lower bid. With increased participation anticipated in a tender, bidding operators will therefore moderate their bid to reduce the risks of losing, and may induce operators to submit a bid very close to their cost of providing the service(s) (ie the competitive outcome). Therefore, the winning bid (the payment by the LTA) is likely to be lower if more operators participate (and are expected to participate) in the tender.

29 This aspect of choice shows why an optimal outcome cannot be guaranteed by a single bid even where the bidder has no knowledge of whether other operators are bidding. Because of the differences between operators, its bid may be substantially different from that which would be made by another operator, and may or may not be well matched to the LTA’s requirements. To put it another way, if a second operator bids for a contract, barring the unlikely possibility that its bid is exactly the same as the first bid, there is a 50 per cent chance that the LTA will have received a better bid.


31 Arriva, in contrast, commented that ‘More bidders is neither a necessary, nor sufficient, condition for expected revenue to increase (or for the outcome to customers to improve)’ and referred a counter-example given in exercise 8(iii) in the online version of a book by Paul Klemperer available at www.paulklemperer.org/index.htm. In this example of an auction with three risk-neutral bidders with different private signals, where the value to the three bidders is equal to the highest signal, the expected price is decreasing in the number of bidders. Arriva told us that this example was analogous to ‘bus companies which each have different expectations of the cost of running the tender, but the actual cost of the tender is equal to the highest of these expectations’. We are not persuaded that this very specific example is generally applicable to the tenders for supported local bus services.

of bids that they received, and some examples are detailed in Appendix 13.1, Table 15. In these cases, the levels of competition experienced were very low.

13.42 Our analyses also indicate that the number of bidders in a tender affects the outcome of that tender process, ie that more bidders tends to correspond to lower price increases. Our quantitative data set shows the difference between the current winning bid and the winning bid in the previous tender at renewal, as a function of the number of bidders (see Figure 13.2). While suggesting a relationship where an increasing number of bidders reduces the proportionate increase in price at tender renewal (barring the large increase in price at 11 bidders), we recognize that there are many different factors at work which could influence price changes and the attractiveness of particular contracts to bidders.

**FIGURE 13.2**

Average percentage difference between winning bids in the current and previous tender ranked by number of bidders*

![Graph showing average percentage difference between winning bids in the current and previous tender ranked by number of bidders.]

*Where this proportionate difference is expressed as share in the previous winning bid, ie difference = (current winning bid – previous winning bid)/previous winning bid).

13.43 The hypothesis that the number of bidders affects the change in price is also supported by the results of our econometric analysis (see Appendix 13.2, Analysis 5, paragraphs 44 to 48 and Table 6), even when taking account of a variety of other factors. These models show that for tender contracts which were re-tendered on the same specification, the difference between the current and previous winning bids is on average lower if the number of operators bidding in the (current) tender is larger. We also looked at how outcomes varied with the number of bidders and found that ‘adding’ an extra bidder has a marked effect on limiting price increases in tenders.

33 This ensures comparability of contracts whose prices we compared.
with two or three bidders. However, this effect is not found to be statistically significa-
cant when increasing bidder numbers above five bidders. This suggests that typi-
cally, a position is soon reached where there are sufficient multiple bidders to be
good enough to ensure competition (see Appendix 13.2, paragraphs 46 to 48). The
analysis discussed in this paragraph is subject to some problems of endogeneity, as
discussed in Appendix 13.2, paragraphs 42 and 43. This arises if operators could
anticipate not only how many rival operators would bid but the value of their bid, and
so their own bidding decisions are influenced as a result. We do not think it is likely
that this will affect our regression results to a great extent.34

13.44 Therefore we conclude that a low number of bidders reduces competition, because
we see evidence of a reduction in competitive pressures on pricing. We would expect
the same observation to apply to other competitive characteristics including aspects
of quality. While it is possible that a fully competitive price could be achieved with a
low number of bidders, these results indicate that factors which reduce the number of
bidders for a tendered contract are likely to have the effect of impeding effective
competition. In addition, the incentive on each of these bidders to compete by struc-
turing their bid as competitively as possible will depend on various other aspects of
the tender design and tender process, which will influence how the bidders perceive
the likely return and risks attached to the particular tender. For example, operators
are likely to require a higher expected return if they believe there are higher risks and
uncertainties attached to the revenue and costs in a tender compared with normal
levels. These factors are discussed below.

Competition in the market for the tendering of supported services

13.45 We now consider various issues in relation to competition in the market for the
tendering of supported services, covering the nature of the tendered contract and the
structure of the market, tender design, barriers to entry, coordinated effects, and
gaming of the tendered market system.

Nature of the tendered contract

13.46 The service that is being tendered will have some inherent aspects, by which we
mean the nature of the service that the LTA decides it wants to support, rather than
how it then chooses to organize the tender process and the terms of the contract.
Aspects include the location of the route and when support for the service is required
(all day, Sundays only, evenings only, etc). These aspects need to be judged in the
context of the operating environment.

13.47 We asked LTAs why they believed that some tenders receive fewer bids. The main
reasons given related to the characteristics of the route being tendered and to the
local market (see Appendix 13.1, Table 3). We consider here whether particular
contracts may attract few bidders because of the inherent characteristics of the
particular contract.

13.48 The DfT told us that tendered routes ‘usually consist of low density routes in rural
areas and extra services in early mornings, evenings and on Sundays’. As shown in
Appendix 13.1, Table 3, LTAs advised us that these types of services were often
unattractive to bidders (21 per cent of LTAs responding said that these factors were

34 The main driver of the attractiveness of a tender will be the value of expected winning bid. In contrast, the difference between
the current and previous winning bid will not itself be likely to determine the attractiveness of a tender to bidders, so this poten-
tial problem is not likely to affect our regression results to a great extent (see also the discussion in Appendix 13.2, paragraph
43).
reasons why there might be only one bidder for a contract). Many smaller operators do not operate any services on a Sunday or would find it uneconomic to keep depots open in the evening and beyond one driver’s shift. Other reasons identified by LTAs included unattractive services (18 per cent), rural services (14 per cent), off-peak shopper services and low patronage (3 per cent each). Rural services may also be some distance from an operator’s base.

13.49 The nature of the contract may also deter some bids if it requires a large number of vehicles or specialist vehicles. 9 per cent of LTAs responding (see Appendix 13.1, Table 3) said that the number of vehicles required for a contract could lead to a single bid being received. Our quantitative analysis found that demand-responsive services, and park-and-ride services, attract fewer bids (see Appendix 13.2, Table 2). This is unsurprising given the specialist nature of demand-responsive services and may reflect the likely high size and quality standards demanded for park-and-ride contracts. The analysis also shows that partial tenders the timetable or route, including those where the rest of the route is operated commercially, reduce the number of bidders. This indicates that operators may be unwilling to bid for contracts where they can provide only a few of the services or are required to run just a small part of a route; they may also perceive that they are at a relative disadvantage compared with operators already in the area or operating the commercial portion of these routes. The analysis reported in Appendix 13.2, paragraph 30, shows that smaller operators are less likely to bid for partial tenders (compared with where the whole route is tendered), but the effect on Main Operators is mixed.

13.50 While the nature of the contract will affect how operators bid, we do not consider this further because the nature of the contract defines the product or service that LTAs wish to procure. Rather, our concern is with the process of competition within the provision of that particular contract.

**Market characteristics**

13.51 The nature of the local market for bus services, such as the structure of supply and the number of operators, may influence the number of bidders for tendered services in the area and the way in which they compete for tenders. In paragraphs 11.33 to 11.40, we have found that local market structures and high concentration (in combination with other features) influence competition in the supply of bus services.

13.52 The distance of the service from an operator’s depot may affect the ability to run the service, and the costs of running the service when incurring substantial dead time. We therefore considered whether the number of operators in a local area could influence the number of bidders for tenders, if operators outside the local area could not bid cost-effectively.

13.53 On average, LTAs reported a reasonable number of tendered service operators in their area (see Appendix 13.1, Table 4; there were an average of 15 operators per LTA, this number being higher for shire LTAs (at 30) and lowest (at eight) in Welsh LTAs). Some areas had relatively few operators, and we were told that in remote rural areas there may be few operators nearby who would be able to bid for a contract without investing in new facilities or recruiting extra staff. The PTE areas tend to have a relatively high number of operators and generally enjoy an above-average

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35 Where part of a route is tendered, the rest of the route may be operated commercially, or sometimes it may be operated partly or wholly as a separate tendered service.

36 The number of bids may also depend on the size of the contract, with operators considering small contracts not worth the bother of bidding unless it fits closely with their existing business. Contract size is not included in this analysis.

37 That is, operators but for the ‘Main Operators’; see also Appendix 13.2, paragraph 10.
number of bids per tender. However, this is not uniform, with Metro (West Yorkshire ITA) receiving only 1.6 bids per tender.

13.54 LTAs also mentioned that the existing market structure affected the number of bids (see Appendix 13.1, paragraphs 40 and 41). Appendix 13.1, Table 3, shows that 15 per cent of LTAs attributed the reason for receiving only one bid on some contracts to a lack of other operators in the area. The Welsh Government emphasized some of the specific demographic and geographic factors that affected the market structure and competition in Wales. The Scottish Government told us that in Scotland ‘The level of competition for these tendered services is governed by the presence of operators with the resources to provide such services and these have their origins in the historical shape of the bus industry prior to deregulation’ (see Appendix 13.1, paragraph 22). Fife told us that the low number of bids it received was due to territorial entrenchment, with Stagecoach being the only significant operator in the area.

13.55 We undertook an econometric analysis of the reasons influencing the number of bidders for tenders—see Appendix 13.2, Analysis 1 and Table 2. This shows that where certain Main Operators have a high share of all services in an area, this can reduce the number of bids. This may reflect there being fewer potential bidders, in a market where the provision of all bus services, supported and commercial, is more concentrated with certain operators holding a high share of service frequency.

13.56 We considered whether there was empirical evidence of an effect of local market structure on the number of bids by comparing the number of operators present in a given LTA in 2009 against the number of bidders, controlling for other factors that may influence this (see Appendix 13.2, paragraphs 21 and 22). The data period spans tenders with start years between 2005 and 2010, and so using 2009 data for the number of operators assumes that there have not been major changes to local market structure in this time. The model results are shown in Appendix 13.2, Table 2.

13.57 We find that an LTA with one more operator is shown to have, on average, a 0.5 per cent higher number of bidders once contract type and other characteristics are accounted for. This effect is statistically significant, but very small. This shows that while the number of operators having a presence in an area can affect the number of bidders, this is, on average, only a small influence. We also find that the number of operators in an area does not materially affect the likelihood of individual operators bidding (see Appendix 13.2, Analysis 2, especially the second footnote to paragraph 31).

13.58 We also considered whether there would be any exceptions of this general relationship, eg in areas where there are very few operators, as indicated by some of the statements from LTAs above. From our data set, we plotted, in Figure 13.3, the number of bidders in tenders for a given number of active operators in the LTA (blue diamonds). This shows a great of deal variation between areas. It is worth noting that in contrast to the regressions, the chart does not hold other factors constant (factors such as contract type, type of service, demographics etc). However, if we consider LTA areas with a very small number of operators present, we see that the average number of bidders (black circles) is less, but no pattern is evident for more than a small number of operators present.
13.59 In conclusion, the evidence shows that a lack of operators in an area reduces the extent of competition for tendered contracts to a small extent. This is likely to be because only operators nearby or already operating services nearby will be well placed to serve such tender contracts, and other operators may not feel bidding to be worth the effort or may not perceive that they have a realistic chance of winning a contract when they are at a considerable operational disadvantage relative to local operators.

13.60 However, we find from our quantitative analysis that the effects of market structure are likely to be small. There may be less of an effect in tendered services than in commercial services because, as addressed in paragraphs 13.122 to 13.137, while barriers to entry apply, entry into the supported market appears to be somewhat easier than the commercial market in many cases. Therefore potential bidders may arise from outside the existing area through new entry or expansion from areas nearby.

Tender design

Introduction

13.61 We next consider the impact of tender design on the effectiveness of competition in the market for the tendering of supported services. Given the nature of the service which an LTA wishes to procure (see paragraph 13.46 to 13.50), it can specify the tender in various ways, for example with regard to the length of the contract, how much detail is specified by the LTA and how much is left to the discretion of the operator, how operators are remunerated for the service and so on. We considered
whether any aspects of tender design had the effect of discouraging operators from bidding for tenders or decreasing their willingness to compete for the tender.

13.62 Some operators told us that tender design could impact on the level of competition for tenders. These comments are set out in Appendix 13.1, paragraphs 67 to 103. For example, Stagecoach told us that ‘the policy of the LTA is key to dictating the level of competition achieved for a given tender’. FirstGroup said that:

The LTAs and PTEs control the success of the tendering process and subsequent service provision. In circumstances where an LTA or PTE ‘gets it right’ (in terms of specification, duration and support), tendering of services is a success, with many bids being received. However, approaches currently vary across the UK and there is no uniform best practice.

FirstGroup also told us that requirements of LTAs were not consistent and highlighted a report by the National Audit Office\(^{38}\) which stated that LTAs and PTEs could improve the award of tendered services (see Appendix 13.1, paragraph 13).

13.63 We assessed whether aspects of tender design affect competition for tenders using a combination of qualitative evidence from operators, LTAs and other parties, and a quantitative analysis of tender data supplied to us by LTAs. The aspects that have been identified are those which we found were likely to vary between tender contracts. This analysis is set out in the remainder of this section, together with evidence on whether or not this impacts on the number of operators who are likely to bid for a contract or how intensively they will be willing to compete for the tender, based on tender prices achieved. The aspects considered are:

(a) contract periods—see paragraphs 13.64 to 13.67;

(b) bundled contracts—see paragraphs 13.68 to 13.72;

(c) revenue risk (minimum-subsidy contracts or minimum-cost contracts)—see paragraphs 13.73 to 13.77;

(d) availability of supporting information—see paragraphs 13.78 to 13.80;

(e) extent of specification of contract and consideration of non-compliant bids—see paragraphs 13.81 to 13.85;

(f) assessment of bids—see paragraphs 13.86 to 13.89;

(g) fare setting and acceptance of other operators’ tickets—see paragraphs 13.90 to 13.96;

(h) procurement practices—see paragraph 13.97;

(i) actions taken by LTAs—see paragraphs 13.98 to 13.108; and

(j) de minimis contracts—see paragraphs 13.109 to 13.113.

\(^{38}\) National Audit Office in 2005 Delivery Chain Analysis for Bus Services in England (p7). Based upon savings achieved in areas which had undertaken a review the NAO estimated that all LTAs could save 10 per cent in the cost of supporting subsidized services by moving to longer contracts and reducing administrative costs.
Contract length

13.64 There was substantial variation in LTAs’ practices in respect to contract length. The average from the whole sample was 4.2 years, with the average length of contract for individual LTAs varying from 18 months to seven years. In some cases, contracts were for an initial period with the possibility of an extension—so, for example, three years with a possible two-year extension. Some LTAs told us that they were either considering or actually increasing the length of contracts, especially now that the maximum contract length in England was eight years (as a result of the 2008 Act). There were no significant variances to the average length by type of LTA. We found that PTEs and unitary authorities were slightly below or at average, whilst Scotland and Wales were slightly above average.

13.65 We would expect longer contracts to be attractive to operators because they provide greater certainty and can justify investment in additional or replacement vehicles and other facilities. Some operators told us that longer contracts would help encourage bidding, eg Transdev Blazefield told us that longer-term contracts are generally more attractive. Other operators said that longer contracts were important if investment in new vehicles was required to operate a contract—see Appendix 13.1, paragraphs 68 and 69.

13.66 In our quantitative analysis (see Appendix 13.2, Analysis 1, Table 2, and Analysis 5, Table 6),39 we looked at whether the duration of the tender affected the number of operators bidding for the tender, and also whether the duration of the contract affected the proportionate increase in price experienced where similar contracts were re-tendered. This quantitative analysis shows that a longer contract duration has the effect of stimulating more bids and results in lower cost increase. The effects were found to be statistically significant. However, the coefficients, indicating the size of this effect, are small.

13.67 This combination of quantitative and qualitative evidence confirms that longer tender periods are likely to create a greater incentive for operators to bid for such contracts and so increase the number of bidders and the incentives to bid competitively, albeit that the impact does not appear to be large. However, against this we note that longer tender periods will reduce the frequency with which LTAs can market-test the contracts in order to ensure that they are still receiving the best value for money, and so will foreclose the market to other operators coming in.

Bundled contracts

13.68 It is very common for more than one contract to be issued in a tender and for bundled bids to be allowed. As set out in Appendix 13.1, Table 9, only 21 per cent of LTAs said that they never offered multiple contracts in a tender and 62 per cent did so always or mostly. 85 per cent of LTAs said that they always or mostly allowed operators to make bundled bids for contracts. Therefore operators can usually submit bids for multiple contracts which may allow some efficiencies in operation, or support investment in vehicles and facilities. However, over 80 per cent of LTAs require bids

39 As explained in detail in Appendix 13.2, paragraphs 42 and 43, reverse causality between the difference between the present and previous bid and the number of operators bidding may in principle lead to spurious results in Analysis 5 (more technically the bidder number might be ‘endogenous’ in this regression). However, since the expected bid difference will not likely deter- mine the attractiveness of the given tender for potential bidders, this reverse link is likely weak at best and will thus most likely not significantly affect our results. Furthermore, the results of Analysis 5 are potentially less reliable since we do not have information on the previous tender other than winning operator and the value of the winning bid (see paragraphs 48 and 51). Since we have not seen evidence of a trend in, for example, bidder numbers or contract duration, we have no reason to assume that a trend in those explanatory variables, and not the tender characteristics considered in the analysis, drive the results.
to be also expressed at an individual contract level. This has the effect of allowing contracts to be spread among operators and means that smaller operators who do not have the scale to serve multiple contracts are not necessarily excluded.

13.69 This bundling of contracts has two possible effects. It can allow operators to use vehicles efficiently across different contracts. Large-scale contracts can justify the costs of new entry or specific investment. On the other hand, smaller operators may not have the capacity to service large contracts. This can create conflicting incentives in how to encourage competition.40

13.70 Most operators told us that offering contracts of the smallest possible size in terms of vehicle requirement could help small operators to bid. In contrast, some operators told us that relatively small tenders may not be sufficient to encourage new entry into an area, and so preferred substantial bundles of tenders to be offered—see Appendix 13.1, paragraphs 70 to 73. While this facilitates entry on a significant scale, smaller operators expressed concern that this might mean they could not hope to offer such a range of services. We asked Small Operators to what extent different factors might discourage them from bidding for a tender contract—see Appendix 13.1, Table 13. Almost half of Small Operators said that they would be deterred from bidding on a bundled contract (17 per cent to a large extent, and 29 per cent to some extent).

13.71 Our quantitative analysis found that bundling of tenders has a weak impact in reducing the number of bidders for tendered contracts (see Appendix 13.2, Analysis 1, Table 2). However, the analysis found that bundling appears to be associated with a lower increase in price at tender renewal (see Appendix 13.2, Analysis 5, Table 6) suggesting that it can yield efficiency advantages (although this analysis should be treated with some caution because of potential endogeneity issues).

13.72 In conclusion we found mixed evidence on whether the use of bundled contracts increases or decreases competition for tenders and so did not draw any conclusions on this issue.

Revenue risk

13.73 LTAs offered a mix of minimum-subsidy and minimum-cost-based contracts. As shown in Appendix 13.1, Table 9, 58 per cent of LTAs said that they generally invited tenders on a minimum-subsidy basis only, 15 per cent on a minimum-cost basis only, and 25 per cent said they generally invited bids on both bases. Many LTAs expressed a preference for minimum-subsidy contracts; such contracts transfer the revenue risk to the operator. This improves budgetary certainty for the LTA and could incentivize the operator to provide a high-quality service and to promote it in order to grow revenues. However, some LTAs choose to offer or require minimum-cost contracts. B&NES Council41 noted that minimum-cost contracts may be beneficial in encouraging bids particularly where there may be uncertainty over revenue streams (eg because of an absence of data following commercial deregistration, or if service frequency, reimbursement levels or other factors are changing substantially). Bristol City Council42 told us it used gross cost contracts because it wanted to retain as much control as possible, especially with regard to fares, as part of its wider transport policy.

40 The relevant LTA will have to carry out consideration of the Competition Test in relation to this bundling.
41 B&NES response to remedies, p7.
42 BCC hearing summary, paragraph 11.
13.74 There was a range of views expressed about whether taking the revenue risk in a contract provides a welcome incentive to develop the service or discourages bidding. Some operators told us that they preferred to take the revenue risk as they could then benefit from encouraging patronage on the route. There was some consensus that where tendered revenue was unstable or unproven, minimum-subsidy contracts were less attractive (see Appendix 13.1, paragraphs 87 to 93). FirstGroup suggested that these contracts required detailed local knowledge of local demand, but said that small operators may often be best placed to benefit from this.

13.75 Based on responses to our small operators’ questionnaire (see Appendix 13.1, Table 13), while 79 per cent of small operators said that they would not be deterred from bidding because a contract was cost-based, only 54 per cent said the same for subsidy-based contracts. This indicates that more operators are deterred from bidding where they have to take the revenue risk, but this effect was not universal.

13.76 Our quantitative analysis confirmed that some operators are less inclined to bid for minimum-subsidy contracts. Specifying whether bidders have to apply a minimum-subsidy or minimum-cost contracts reduces the number of bids (see Appendix 13.2, Analysis 1, Table 2). This analysis also shows that minimum-cost contracts reduce the number of bidders for a contract, which suggests that there are some operators who would rather have the freedom to try to grow the route. However, the quantitative analysis did not establish a link between minimum-subsidy-only contracts and minimum-cost-only contracts, and the change in price at contract renewal (see Appendix 13.2, Analysis 5, Table 6).

13.77 Therefore, we conclude that the use of tenders which do not offer a choice of minimum-subsidy or minimum-cost bids can reduce the number of bids for contracts.

Availability of supporting information

13.78 Two thirds of LTAs said that they provided patronage or revenue data, where it was available (particularly at re-tenders of existing services) to potential bidders to enable them to evaluate potential business (see Appendix 13.1, Table 10). Information is usually collected where a route is operated on a tendered basis but this is not always then provided to operators bidding for a new tender contract. In cases where previously commercial routes are deregistered and taken over as a tendered service, the previous operator will sometimes provide the LTA with this information but it is not obliged to do so (see Appendix 13.1, paragraph 59(c)). Some LTAs noted that where they had obtained this information it had helped to improve the number and pricing of subsequent bids. This suggests that where this information is absent LTAs may be impeded in their ability to assess whether support for these services is required and for them to attract competitive bids for a tender.

13.79 Some operators said that it was more difficult to tender where there was a shortage of relevant background information—see Appendix 13.1, paragraphs 94 to 98. For example, Rotala, Transdev Bournemouth, Centrebus and Go-Ahead Oxford referred to lack of information creating problems. However, other operators, including Metrobus, Blackpool Transport and Go North East, said that information provision was either adequate or they could work around shortfalls. 11 per cent of Small Operators said that limited supporting information would deter them from bidding for contracts to a large extent, and 35 per cent to some extent, although 54 per cent of Small Operators said that a shortage of information would not deter them from bidding—see Appendix 13.1, Table 13.

13.80 We were not able to characterize whether there was limited information available in particular tender cases for the purposes of the quantitative analysis. However, based
on the evidence available, we found that the availability of supporting information could have an impact on the likelihood of operators bidding and hence the effectiveness of competition for the tender.

*Extent of specification of contract and non-compliant bids*

13.81 LTAs can specify how aspects of service delivery are to be delivered in the terms of the contract. Many LTAs were very prescriptive in their requirements. As set out in Appendix 13.1, Table 10, many LTAs will set requirements covering vehicle characteristics (e.g., capacity, accessibility, emissions standards) as well as specifying the service to be delivered, and in many cases may set out different service/quality specifications and invite bids for different options. However, LTAs can consider bids which are not compliant with the exact terms of the tender specification, and may accept these variants if they appear to offer better value for money. 12 per cent of LTAs always allowed non-compliant bids while 64 per cent would consider them if they accompanied a compliant bid. 68 per cent of LTAs always invited operators to offer alternative bids (e.g., allowing a variant to the service if it allowed a reduction in price) and 18 per cent sometimes allowed this.

13.82 Operators were generally in agreement that an increase in the specification of a contract led to an increase in the cost level of the bid. However, as discussed in Appendix 13.1, paragraphs 74 to 80, there was little evidence that particular aspects of the specification would generally deter operators from bidding. There were few concerns from operators about penalties that may be associated with a failure to deliver the contract, e.g., in Appendix 13.1, Table 13, 73 per cent of Small Operators said that penalty provisions would not deter them from bidding for tenders.

13.83 There were mixed views expressed about whether the ability to make alternative bids (such as variants which, while non-compliant with the tender, may provide a cheaper option which could offer good overall value for money to the LTA) would help alleviate overspecified contracts. Some thought this might make the process more cumbersome (see Appendix 13.1, paragraphs 81 and 82).

13.84 Our quantitative analysis showed some effect on the price of the winning bids from how they are assessed; Appendix 13.2, Analysis 5, Table 6, shows that where non-compliant bids win, cost increases to LTAs may be lower. This is unsurprising as an LTA is likely to favour a non-compliant bid only where there is some significant benefit in doing so. It also shows, as would be expected, that if the LTA chooses the lowest-cost bid (rather than a more expensive but higher-quality option), the cost increase is lower. These results suggest that flexible consideration of non-compliant bids can produce benefits to LTAs, because it allows operators to compete for the tender by bidding in more creative ways. However, we cannot distinguish this from an LTA choosing a cheaper option than was specified in the original tender.

13.85 Our analysis did not find a significant link between the number of bidders and whether the winning bid was non-compliant (see Appendix 13.2, Table 2), although this does not record how many bidders submitted non-compliant bids. This is difficult to assess in that where non-compliant bids were unsuccessful because they did not provide the service that the LTA required (rather than just delivering a different but equivalent service), the relevance of the bid to the process of competition is unclear. As a result, we cannot conclude on how the contract specification and treatment of non-compliant bids affects the number of bids or the intensity of competition between them, other than to note that price effects result.
Assessment of bids

13.86 We now consider how LTAs assess bids. The methods used by LTAs to evaluate tenders are set out in Appendix 13.1, paragraphs 61 to 64. These systems influence aspects of tender design in that they determine the extent and form of the information that operators must submit in support of their bid.

13.87 The most significant variance between LTAs was the extent to which a qualitative assessment was required as part of the process. This was more common in Scotland and Wales but less common in England and particularly in the PTEs. As set out in Appendix 13.1, Table 11, 50 per cent of LTAs tended to use points-scoring systems to evaluate both the quality and price aspects of bids, and a further 9 per cent used them to assess the quality of the bid. These allow a systematic evaluation of all aspects of a tender bid. As shown in Appendix 13.1, Table 12, 46 per cent of LTAs said that the key element of their approach to tender evaluation was a points-scoring system, compared with 19 per cent who looked primarily just at cost and a further 12 per cent who said cost subject to meeting basic criteria.

13.88 Operators generally had little to say about differences in these assessment systems. Some operators expressed concern about the amount of information that was required in order to tender for a contract, particularly when the time available to submit the tender was short (see Appendix 13.1, paragraphs 100 to 103). ALBUM told us that the resources needed and the timescale in which tendering processes took place disadvantaged the smaller operators.

13.89 Our quantitative analysis found that points-scoring systems tended to reduce the likelihood of the incumbent winning (see Appendix 13.2, Analysis 3, Table 4). This suggests that the process allowed alternative operators to differentiate themselves on aspects of quality in their bids. However, the use of these systems reduces the likelihood of bidding by Small Operators (those not included in Main Operators; see Appendix 13.2, Analysis 2, Table 3) and is weakly associated with a lower number of overall bids (see Appendix 13.2, Analysis 1, Table 2—this coefficient is significant at the 10 per cent level).43 This may be because the information requirements of tender bids in such cases are greater, which deters smaller operators, or that smaller operators are less able to demonstrate that they conform to some of the qualitative requirements in such systems. This indicates that the use of such systems will reduce the competition for these contracts. However, no statistically significant correlation was found between renewal prices and the use of points-scoring systems.

Fare-setting and ticket acceptance

13.90 LTAs, when they tender services, may direct how fares are to be set for these services. Operators may be free to set the fares they consider appropriate, they may be required to mirror commercial fares for equivalent services in the areas, or the LTA may dictate the fares that are to be charged. Provided bidders are aware of these requirements, they can adjust their bids accordingly. However, our quantitative analysis (see Appendix 13.2, Analysis 1, Table 2) shows some impact of the fare rules chosen on the number of bidders. If the LTA sets fares, or if the operator can set fares freely, this increases the number of bids. However, if fares for the tendered service have to mirror commercial fares, this discourages bids. The interpretation of this is not obvious (and bidders can adjust their bids according to the terms under which fares can be set), and for the ‘main’ operators studied, there is no consistent

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43 See the definitions in the footnote to paragraph 13.22.
pattern. Operators did not raise the issue of fare levels with us in their submissions and questionnaire responses. We therefore reach no finding on this.

13.91 In some cases, bidders may be required to accept other operators’ tickets. For example, evening services may be tendered whereas a commercial service operates in the day, and the LTA may require the tendered service operator to accept valid return and season or network tickets issued by the commercial operator, even though it will receive no revenue for this since passengers would not want to pay again for a service where they had already bought a ticket.

13.92 For example, Bath and North East Somerset Council, in a submission to the CC, noted that it required operators of tendered services to accept season tickets from the incumbent commercial operator. It considered that the high level of season ticket use applying might limit the ability of other operators to bid competitively for these services when they were re-tendered. It said that the council had a strong preference for awarding net subsidy contracts that incentivized operators to improve revenue but extensive use of season tickets reduced the available pool of income for other operators who could not offer the same network or daytime service provision as the main commercial operator.

13.93 While other operators, when bidding for a minimum-subsidy contract, will be able to factor this loss of revenue into their bid, we were told that this placed them at a substantial disadvantage relative to the commercial operator in bidding for a tender. The commercial operator in effect receives a benefit from the tender, as this publicly-supported service adds to the attractiveness of its ticket sales. Rotala noted that either the incumbent operator has an unfair advantage, or the LTA will not require tickets to be transferable and customers are disadvantaged. Where multi-operator tickets are available customers will have to purchase these but these tend to be more expensive than single operator tickets.

13.94 As noted in the Worcester case study (see Appendix 6.4—Worcester, paragraph 81), Rotala had hoped to enter the Worcester market on the basis of offering a network ticket covering the whole length of the day, including tendered evening services. However, it was then required by the LTA to accept First Midland’s tickets on its tendered services, and it said that this had the effect of depriving it of revenue, and rendered the services uncommercial so that it had to forfeit the tenders.

13.95 Our quantitative analysis also found that a requirement to accept other operators’ tickets reduces the number of bids (see Appendix 13.2, Analysis 1, Table 2).

13.96 Overall, we find that a requirement to accept other operators’ tickets can have the effect of reducing the number of bids for such contracts, and it can be expected to reduce the incentive on operators to bid as competitively for such contracts.

Procurement practices

13.97 We received a large number of submissions from operators, LTAs and other bodies, commenting on procurement practices, as set out in Appendix 13.1, paragraphs 82 to 86 and 160 to 166. These said that tendering processes had become increasingly burdensome, with measures disproportionate to or irrelevant to the tenders that were being placed. As set out in Appendix 13.1, some LTAs commented that they were often forced to follow procurement procedures that were common to all procurements.
and which may be inappropriate to bus tenders. In some cases these included information requirements or satisfying criteria which might be irrelevant to or disproportionate to the contracts under consideration, and that their freedom to then consider variant bids or negotiate better deals might be constrained. ALBUM (see Appendix 13.1, paragraph 84) said that the tender process had been driven by EU Procurement Directives. Various parties told us that procurement practices increased the complexity and cost in bidding for tenders, which could result in fewer bids and reduced value for money being achieved, and that this disincentive was likely to have a greater impact on smaller operators and new entrants. Our quantitative analysis was not generally able to characterize differences in procurement practices. These measures are often in place due to the requirements of procurement legislation, and we recognize that many of these measures exist for good reasons to ensure fair and effective procurement. However, we found that there were considerable differences in the interpretation of procurement legislation between different authorities, which has the potential to result in unintended or unnecessary restrictions on competition in the market for the tendering of supported services.

**Actions by LTAs to drive better tender outcomes**

13.98 In designing a tender, LTAs have to make a number of trade-offs, in order to achieve the services they wish to be delivered at the best value for money. LTAs may then have to take a view on whether promoting active competition can best deliver these results. For example, we noted above that more bids can be encouraged if the LTA is willing to offer an option of minimum cost or minimum subsidy contracts or takes the revenue risk itself. However, the LTA may well have good reasons to seek to avoid this risk. TFGM cautioned against LTA’s taking revenue risk in the current climate since the need to predict budgets accurately is an over-riding consideration and minimum subsidy contracts tend to incentivize the commercial operator to grow the market which, in some cases can lead to commercialization of previously tendered services. York City Council made similar points and said it doubted that removing the revenue risk from operators would result in a significantly higher number of bids. PTEG also told us that there were significant structural obstacles to the use of, for example, net cost contracts, not least the asymmetry of information between incumbents and LTAs and the barrier to entry posed by single operator tickets. LTAs might also face a choice between bundling contracts to encourage new large-scale entry and encouraging smaller operators to bid individually for smaller contracts. Specification of quality requirements and rigorous assessment procedures may also deter some bids or increase costs but deliver better quality. These trade-offs are outlined in Appendix 13.1, paragraphs 106 to 111.

13.99 As noted in Appendix 13.1, paragraphs 114 to 120, the DfT issued best practice guidance to LTAs in England advising on the appropriate approach to tendering contracts in order to achieve best results. This guidance notes that there is not one uniformly appropriate approach, rather the terms of a tender need to be tailored to particular circumstances. Tendering is also subject to the OFT Competition Test (see paragraphs 12.81 to 12.83) which gives guidance to LTAs about the factors that might restrict competition, and so helps the LTAs to determine whether these factors are justified through the delivery of benefits such as improved quality. For example, the bundling of tender contracts may exclude smaller operators from bidding effectively, but it may encourage large-scale entry or allow more efficient operation. LTAs

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46 TFGM response on proposed remedies, paragraph 4.2.4.
47 York City Council response to provisional findings and remedies.
48 See PTEG response to provisional findings, paragraph 10.1.
49 See Bus Tendering Good Practice Guide by Atkins for the DfT, 2005. We understand that no equivalent guidance is issued for Scotland and Wales.
may also decide on a higher quality standard to get the best overall result even though this may preclude some smaller operators. Thus there may be a ‘trade-off’ for LTAs between achieving best value or achieving particular service and quality standards, and encouraging the maximum number of bidders.

13.100 We recognize that LTAs need to make judgements on these trade-offs, but in doing so they will need to recognize that decisions on tender design can impact on the process of competition, which in turn can have consequences for market outcomes.

13.101 We found no general consensus among operators about how an LTA can encourage bidding, although we received many views about the influence that an LTA’s behaviour can have on the operator’s decision of whether, and how, to bid.

13.102 Beyond tender design, LTAs told us about a number of actions that they took to encourage more bidders. These are outlined in Appendix 13.1, paragraphs 50 to 52. The use of such approaches varied between LTAs, but the most common approach was wide communication about tendering and building a relationship with local operators. For example, this included approaching all local bus operators, giving advice on procedures to smaller operators and inviting operators in neighbouring areas to bid. Many LTAs negotiate with operators after bids have been received to improve the final terms of the tender agreement. Other LTAs had different perspectives, with some believing that such approaches to operators were inappropriate or might not be allowed. 40 per cent of LTAs told us that they never negotiated with operators after bids were received (see Appendix 13.1, Table 11). 2 per cent of the LTAs (see Appendix 13.1, Table 7) said that they could not approach operators ahead of a tender to encourage more bids because of the restrictions from procurement regulations. 5 per cent of respondents told us that they did not take any actions to increase the number of bids received.

13.103 In a very few cases, LTAs have invested in some vehicles of their own, and can either operate services that would otherwise be tendered on their own behalf, or operators can bid to provide services utilizing the LTA’s vehicles. 7 per cent of LTAs told us that they sometimes provided vehicles to operators under lease (see Appendix 13.1, Table 7). We were told that having these vehicles as an alternative provider helped ensure that bidders offered a competitive price. 50

13.104 We were told of two recent initiatives in tendering practice in Bristol and Dorset where large tranches of tendered services were offered in an attempt to encourage innovation or efficiency in the provision of supported services. Bundled tenders may allow sufficient critical mass to be reached to facilitate new entry by an operator, and this may then lead to that new entrant also using this as a basis for entry into the commercial market, thus increasing competition in the provision of local bus services.

13.105 In 2006 and again in 2011, Bristol City Council (BCC) tendered all its routes simultaneously. In 2006, Rotala had entered the market, and in 2011 Hackney Community Transport had won some park-and-ride contracts. First Group’s view was that this approach had not been wholly successful, as the LTA had received fewer bids than it expected. BCC acknowledged that costs had risen but noted that this reflected reductions in BSOG and concessionary fare payments and operator cost increases. BCC said that it did not allow non-compliant bids or for operators to link up different

50 Go-Ahead noted that there were some examples of operations which were direct labour departments of county councils which sometimes bid for contracts.
51 BCC hearing summary.
52 FirstGroup response hearing summary, paragraph 41.
53 BCC hearing summary, paragraph 14.
54 BCC hearing summary, paragraphs 16 & 17 paraphrased.
services, as despite possibly achieving lower prices it meant the Council might be tied in to supporting services which otherwise it might want to alter.

13.106 Dorset County Council (DCC)\(^55\) decided to tender all its services (including school and social care transport) in one go in 2011. Go-Ahead\(^60\) told us that DCC had put a number of different route contracts together which set out the overall requirement for transport in the local area and specified its needs. Operators then put together a network design and costing to meet this specification. FirstGroup\(^57\) said that the LTA had effectively provided operators with a ‘blank sheet’ and asked them to design their own proposals. CC\(^58\) believed that aggregating the various transport services had been successful and had made providers innovate by having to devise their own packages combining transport solutions, and it had benefitted in terms of both value and cost. The procurement process had resulted in a significant reduction in the number of individual companies doing business with DCC although some smaller operators had been subcontracted by one of the big bus companies that had picked up more than 50 per cent in value of all the work.\(^59\) DCC said that in order to attract competition from outside its area, it had made it possible for bidders to use some of its own depot facilities.\(^60\)

13.107 DCC\(^61\) said that it had received a lot of interest from other LTAs about the tendering process, which it saw as a pilot exercise. Go-Ahead said that it\(^62\) did not have a theoretical view on the benefit of this kind of approach, but it had encouraged local authorities to focus on outcomes rather than tight specifications when tendering contracts for bus services. FirstGroup\(^55\) considered that DCC’s approach was helpful, so long as such exercises complied with legislation and operators were given enough time to develop their bids. Arriva\(^64\) told us that the Dorset example demonstrated the advantages of letting operators be imaginative about all its tendered services. However, local authorities were risk averse and this prevented more of these kinds of innovative solutions, but Arriva thought that overspecification in tenders could lead to less innovation. ALBUM, however, was concerned that this type of one-off tendering exercise could deny the opportunity for operators to enter the market for a set number of years, and may mean that those operators exit the area and therefore it extinguishes the potential for competition.\(^65\)

13.108 The Dorset experience suggests that large-scale and flexible tendering exercises may lead to efficiencies and innovation and may encourage increased competition through expansion or new entry into the market for tendering of supported services (which might also then serve as a base to allow increased competition in the commercial market). Bournemouth Transport (Yellow Buses) won contracts to serve new areas of Dorset, in part using Council facilities as depots, although in practice we understand this expansion has not occurred, see paragraphs 13.133 and 13.134. The approach in Bristol, where BCC simultaneously tendered many individual contracts, could also create opportunities for entry. However, some LTAs said that

\(^{55}\) DCC response hearing summary, paragraph 1.
\(^{56}\) Go-Ahead response hearing summary, paragraph 28.
\(^{57}\) First response hearing summary, paragraph 42.
\(^{58}\) DCC response hearing summary, paragraph 5.
\(^{59}\) DCC response hearing summary, paragraphs 10 & 14.
\(^{60}\) DCC response hearing summary, paragraph 24.
\(^{61}\) DCC response hearing summary, paragraph 20.
\(^{62}\) Go-Ahead response hearing summary, paragraph 28.
\(^{63}\) First hearing summary, paragraph 42.
\(^{64}\) Arriva response hearing summary, abbreviated version of paragraph 33.
\(^{65}\) Album response hearing summary, paragraph 28.
tendering regularly rather than in one tranche helped maintain competition in the market.\textsuperscript{68}

\textit{De minimis contracts}

13.109 In de minimis contracts, the LTA awards the contract without going out to tender. It is typically used for small-value contracts, and may be used where there is one operator obviously well placed to provide the service (for example, to provide a small extension to a service, to divert a commercial service such as to serve a school, or for a few additional early morning or late evening services). This has the advantage of saving on tender costs for the LTAs and operators and speeds up the tender process. Passengers benefit from continuity of ticketing and operator. In some cases, there may be no other operator who can effectively bid to do the tender without incurring far higher costs. However, use of de minimis contracts removes the potential to realize any gains that might come from competition (although LTAs may still have some negotiating ability with operators, eg through using benchmarking to determine whether the de minimis contract offers reasonable value for money). The LTAs we spoke to expressed confidence that they had the experience and market knowledge to ensure that they were achieving best value through this approach. Evidence relating to de minimis contracts is set out in Appendix 13.1, Annex B.

13.110 Although we have incomplete data, our best estimate based on information received from LTAs is that on average 12 per cent of contracts by value are awarded in this way, and a higher proportion by number.

13.111 The de minimis provisions are as follows. In England, for authorities with a total subsidy spend of less than £600,000, any individual subsidy contract of less than £30,000 in any one year does not have to be tendered. For authorities with a spend over £600,000 a year, up to 25 per cent of contracts by value do not have to be tendered. The DfT has consulted on proposals to extend the exception in England to that possible under EU regulations, but no decision has been announced on this.\textsuperscript{67} Wales has a de minimis exception at 40 per cent by value of contracts; the Welsh Government told us that it had assessed that this provided a cost-effective way of making small extensions to services, especially given the variation in population density in Wales and often low average budgets of the LTAs.\textsuperscript{68}

13.112 We did not have the necessary information to enable us to carry out a quantitative analysis of effects on competition; their nature means that detailed and consistent records of these contracts are often not kept.

13.113 De minimis contracts are used in cases where the size of the contract is so small that the costs of a tender process cannot be justified or otherwise there is little scope to offer the contract efficiently to more than one bidder. This obviously creates risks of inefficient outcomes where guidelines are not followed or operators have an incentive to seek to manipulate these arrangements to their own advantage. Although we have no strong evidence that this happens on any significant scale, and the Part 1

\textsuperscript{66} eg Merseytravel, response hearing summary, paragraph 23.
\textsuperscript{67} This is discussed in Appendix 13.1, Annex 2, paragraphs 29–32. The DfT has consulted on increasing the exemption in England to levels allowed under EU legislation but no policy change has yet been announced (EU regulation 1370/2007 allows, subject to national limits, the exemption from competitive tendering of public transport contracts up to an annual value of €1 million or 300,000 km awarded by a competent authority. For operators with fewer than 23 vehicles, these thresholds may be increased to €2 million (and or 600,000 km).
\textsuperscript{68} The Welsh Government also argued that higher de minimis limits would be beneficial as this might encourage more smaller operators to bid for services. De minimis contracts are sometimes used to allow a simplified procurement procedure but the contracts are still offered for competitive tender. The Welsh Government noted that the thresholds for de minimis contracts are lower in Wales than England—this would seem to facilitate the use of de minimis in this way.

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Competition Test provides guidance on assessing the impacts on competition from adopting de minimis, we note that competition for tenders is likely to lead to benefits in lower prices and/or better quality of provision. Therefore, we are concerned that any extension of the exemptions on de minimis contracts is likely to weaken competition in the tendering of supported services and so reduce the benefits that arise. For this reason any revision to the thresholds to allow greater use of de minimis contracts should be treated with caution. In particular, options to simplify procurement processes (see paragraph 13.97) so as to make the cost of tendering more justifiable are likely to be a preferable approach.

**Differences in tender arrangements in Scotland and Wales**

13.114 We noted that the DfT’s guidance on procurement of tendered services is applicable to England but no equivalent guidance is issued for Scotland and Wales. The guidance is several years old and there seems to be no particular reason why guidance on best practice should not be equally relevant in Scotland and Wales. We have no evidence on the extent to which LTAs in these areas follow similar principles as suggested in this guidance in practice.

13.115 We noted that price increases seemed more prevalent in Scotland and Wales compared with England (see Table 13.2), and our analysis of information provided by LTAs showed that there were on average fewer bids for tenders in Scotland than the rest of the country (see Appendix 13.1, Table 2). We heard from LTAs in Scotland that there were different perspectives on their ability to encourage other operators to bid for contracts, to engage in any negotiations after bids had been submitted, or to utilize de minimis arrangements.

13.116 However, we received no indication to suggest that these outcomes were in any way driven by the absence of specific guidance on tendered service procurement for Scotland or Wales, nor any other aspect of policy, regulation or other factors in these countries. We therefore found that the issues arising were a matter of local market structure and tender design which could arise for any LTA within the reference area.

**Summary of findings on tender design**

13.117 We have found that aspects of the design of tenders and the tendering process can reduce competition for contracts, in that they either reduce the number of operators who are willing to bid for contracts or can reduce the extent to which they are incentivized to bid competitively in order to win the contract in relation to the following aspects:

- use of short contract periods; see paragraphs 13.64 to 13.67;
- use of either minimum-subsidy contracts or minimum-cost contracts without the option of bidding on the other basis—see paragraphs 13.73 to 13.77; and
- not providing all relevant information to bidders—see paragraphs 13.78 to 13.80.

13.118 In addition, we found that the following aspects of tender design can also impede competition for tenders although we acknowledge that the evidence of this having a sizeable effect is weaker.

- not considering non-compliant bids—see paragraphs 13.83 to 13.85;
- use of point-scoring assessment systems—see paragraphs 13.86 to 13.89;
• requiring operators accept other operators’ tickets—see paragraphs 13.91 to 13.96; and

• the use of de minimis contracts—see paragraphs 13.109 to 13.113, where by definition there is no competition for contracts.

13.119 In addition, we note that aspects of procurement practice can act to inhibit bids or increase the cost of bidding, and may particularly act on small operators (see paragraph 13.97.

13.120 These aspects of tender design have the effect of making bidding for tenders less attractive and so reducing the intensity with which operators compete in setting their bids, and/or dissuade operators from bidding at all. As a result, some operators who might otherwise have bid are dissuaded from bidding, and so there is a lesser degree of rivalry in the tender process. This may be because operators are being asked to take on greater risk, they are required to bid without all the relevant information which increases uncertainty, the costs of preparing a bid are higher, the period over which the operator can expect to recover any necessary fixed costs are reduced, and so on. As shown above, both empirically and theoretically, fewer bidders is likely to lead to higher prices because the degree of competition is less. We also note that tender design is visible to operators and so, in addition to these effects, they may anticipate that fewer rivals are likely to bid and this will affect their bidding strategy.

13.121 We note that there are often good reasons for adopting a particular approach to the design of a contract, including assuring the delivery of an appropriate service in accordance with the objectives of the LTA, trading off measures to encourage the maximum number of bids for a tender and achieving other objectives. The LTA also needs to factor in the costs and time involved in running an open tender. These factors are already reflected in the guidance on best practice that is available to LTAs in England. Nonetheless, the quantitative analysis compares outcomes for tenders where the relevant LTAs have already made a judgement on appropriate tender design, and this analysis still shows identifiable consequences for competition in aspects of tender design.

**Barriers to entry**

13.122 We considered whether any barriers to entry apply to tendered services, over and above those that apply to commercial services (see paragraphs 9.210 to 9.220), or whether any barriers to entry in commercial services do not apply to tendered services.

13.123 The majority (56 per cent) of LTAs told us that they had seen examples of entry, although this was lower in Scotland and Wales (see Appendix 13.1, Table 6). We noted that there are a number of entry routes which could suit a variety of operators—see Appendix 13.1, paragraph 48. We were referred to examples of operators who started by offering tendered services who have grown over time and expanded into the provision of commercial services on a significant scale, including Norfolk Green, Western Greyhound and Centrebus.

13.124 Operators and LTAs raised very few specific concerns about barriers to entry for tendered services. While there are obvious costs involved in preparing bids for contracts, and a risk of being tied into a contract if the assumptions on costs and revenues made in a bid turn out to be incorrect, some operators told us that this market was more attractive than the commercial market. This arose partly because there is likely to be less risk, because some or all of the revenue stream is guaranteed through tender income (unless an LTA chooses to cancel a contract). We were
told that small contracts were unlikely to be sufficient to encourage operators to enter from other areas (see Appendix 13.1, Table 8). Because supported services do not generally face competition from commercial services, operators would be less likely to have to worry about the competitive responses of incumbents (than for commercial services). They are also less likely to face concerns about incumbents’ market power arising from period or network tickets or any network advantages that would make rivals more attractive to customers. In so far as these aspects are a disadvantage, this can be reflected in the bid prices for tenders. However, some of the smaller operators told us that the investment required to operate larger-scale contracts (such as larger bundled contracts or some park-and-ride contracts) may be beyond their resources.

13.125 We considered whether there were any economies of scale or scope in relation to the operation of tendered bus services. A barrier to entry could potentially arise if a larger operator on a local scale could expect to benefit from lower unit costs and so would be more likely to win a tender. Our analysis of economies of scale in Appendix 9.6 in relation to the commercial market found that there were some economies of scale for small depots, but there were generally constant returns to scale for medium and large depots, based on analysis of the multi-regional operators’ depots. Cost comparisons between Small and Large Operators did not show clear evidence of any scale effects.

13.126 Our quantitative analysis (see Appendix 13.2, Analysis 1, Table 2) found that the number of bidders for contracts is lower if the incumbent is one of the ‘main’ operators. This might suggest that a smaller number of operators feel that they are able to win such tenders. Appendix 13.2, Analysis 2, Table 3, also shows that operators are more likely to bid if they are incumbents and if their share of routes in the LTA is high. This might suggest that operators significant in an area perceive that they have lower costs or are better placed to bid. However, no such effect shows up consistently in our analysis of the probability of winning tenders, measured by the operators’ share of frequency of all services in the LTA area (see Appendix 13.2, Analysis 4, Table 5). We also note that smaller operators frequently win tendered contracts. We received no evidence indicating that other operators were reluctant to bid against a larger operator. The reduction in the number of bids where Main Operators are present may therefore just reflect the possibility that there are fewer potential bidders in an area where market concentration is relatively high. Incumbents whose share of local bus provision in an area is high are likely to want to keep operating a service and so will be likely to bid; they may also well be best placed to integrate such work with their existing operations.

13.127 In conclusion, we found little evidence that economies of scale/scope are a barrier to entry in tendered services.

13.128 Turning to incumbency advantages, we see (Appendix 13.2, Analysis 4, Table 5) that incumbency increases the likelihood of winning a tender. This could arise because an incumbent might have an information advantage over rivals if not all route

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69 Although this analysis does not control for the size of alternative operators, some of which may also be large.
70 FirstGroup noted that the analysis did not control for the number of operators who were present in a local area. It presented evidence showing that where more small operators were present, there tended to be more operators in total. It said that this indicated that where small operators were incumbents, it was likely that there would be more operators able to bid. It therefore said that this result reflected the geographical distribution of operators rather than showing that Large Operators held an incumbency advantage. To assess this, we reran the regressions including the number of active operators as explanatory factor. Since the results are not materially different from those reported in Appendix 13.2, Tables 3 and 5, we do not include these results. This observation suggests that the number of active operators has no material effect on operators’ bidding decision once the number of other bidders in the tender is included in the specification (which is consistent with the finding that the number of operators in a given LTA has a negligible effect on the average number of bidders for tenders—see Appendix 13.2, Analysis 1, Table 2).
performance information is shared (see paragraph 13.78) and it can bid with a greater degree of knowledge and certainty (some Small Operators reported that they would be deterred from bidding if there were a shortage of relevant information—see paragraph 13.79). There may also be an advantage to an incumbent if an LTA is assessing tender bids informally; if the operator has performed well up to re-tender, the LTA may consider it low-risk to renew the tender rather than taking on a different operator. We see that where LTAs use a points-scoring tender assessment methodology (see Appendix 13.2, Table 4), the likelihood that the incumbent wins is reduced, which might be because this systematic evaluation reduces incumbency advantages as all operators are assessed on the same basis. However, the previous operator winning a tender appears to be associated with a greater difference between the current and previous winning prices (see Appendix 13.2, Analysis 5, Table 6). This suggests that there could be a barrier to entry in the form of an incumbency advantage.

13.129 However, there was little qualitative evidence to support this interpretation. Operators did not allege that incumbents received any preferential assessment when tender bids were evaluated, and there was no evidence that this occurred. It is likely that incumbents will be best placed to make an accurate assessment of relevant factors when formulating their bids for a tender, although there were few complaints that insufficient information was made available to formulate bids.

13.130 An alternative explanation could simply be that the incumbent operator continued to be best placed to bid competitively and so will tend to win again. For example, incumbents may benefit from advantageous depot location, or may just be more efficient than competitors. Incumbents may be motivated to bid competitively in order to retain their business, if it is a substantial part of their activities or integrates well with their other services. These are benign explanations which suggest no failure of competition in incumbents having an increased likelihood of winning a tender. We cannot distinguish between these explanations and those in paragraph 13.128, and so we reach no conclusions on this.

13.131 We also considered whether there were any differences in the way the barriers to entry identified in paragraphs 9.210 to 9.220 applied to the operation of tendered services alone. We note that new tender service operators are unlikely to have to take account of the intensity of post-entry competition, as tendered routes are unlikely to overlap substantially with competing commercial services. Some aspects of sunk costs will also apply to tendered services. For example, there are sunk costs in bidding for contracts, establishing a base, recruiting and training staff and possibly in obtaining vehicles, even though some sunk costs (e.g., promotion for minimum-cost contracts) may be less relevant for tendered services. The time taken for a route to reach profitability is likely to be less relevant as usually tenders will not be for a completely new route, and where they are, the costs of the time taken for revenues on minimum-subsidy contracts can be built into the bid. Entrants might face difficulties in finding a suitable depot site but such entry is unlikely to be large scale that would require a major depot. Access to bus stations is unlikely to pose a barrier to entrants as LTAs are likely to require that such access is granted before offering a tender.

13.132 We considered whether the reaction of other operators to a new entrant winning a tender could constitute a barrier to entry. Once an operator has won a tender, a rival could register a commercial service to either abstract revenue (for minimum-subsidy contracts) or to persuade the LTA to terminate the contract. A possible motivation might be to establish a reputation which deters rivals bidding for contracts, or to stop an operator establishing itself with tendered services and then expanding from there into further tendered or commercial services. However, it is difficult to see that this could be a successful long-run strategy as the market is likely to be open to potential
new entrants at every subsequent re-tender, and so the pay-off from such strategies may be limited. In addition, repeated behaviour in this way would be apparent to an LTA.

13.133 We did not receive a great deal of evidence about exclusionary behaviour by operators from our qualitative questionnaire. We noted that the practice of registering a commercial service over a tendered service has been widespread, with 39 per cent of LTAs reporting this practice, but not all of the LTAs viewed this as a deliberate reaction to a rival's entry. We were, however, notified of one sizeable incident which might have had the effect of excluding a new entrant who could have become established in the provision of tendered and commercial services. This is described in detail in Appendix 13.1, paragraphs 154 to 157. In this case, registration of some competing commercial routes by two other operators, following a planned large-scale entry event where an operator (Bournemouth Transport) had won a significant bundle of routes following a substantial tender exercise in Dorset, had the effect of forcing the prospective entrant to cancel its intended entry.

13.134 Based on the explanations provided by the operators as to why they registered and ran competing commercial services, it appears that a range of factors drove their behaviour. We therefore do not conclude on whether there was exclusionary intent in the operation of these commercial services over the tendered services awarded to the entrant, Bournemouth Transport. Nevertheless the result was that Bournemouth Transport did not enter the market. There is a risk in any tendering exercise that an operator that is not the contract winner might choose to run commercial services in competition with the tendered services knowing that generally the LTA will then cancel the contract. As a result the probability is reduced that a significant bundle of tenders can be used to establish a new operator. On the other hand, the LTA benefits from supported services being operated commercially, and in the case of Dorset, we note that the commercial market was still subject to change, particularly in the emergence of Dalmory (a Go-Ahead subsidiary) as a much more significant presence in parts of the county.

13.135 Oxfordshire LTA told us that it had a policy not to terminate prematurely a subsidy contract which has already been entered into in response to commercial service registrations—see Appendix 13.1, paragraph 158. It could be that an operator identifies a potentially viable commercial opportunity. Only a few of the Small Operators reported that they might be deterred from bidding depending on the likely rival bidders—see Appendix 13.1, paragraph 136. In the response to the Small Operator questionnaire, 9 per cent of respondents said that they would be deterred to a large extent, and 15 per cent to some extent, by the likelihood of rival bidders—see Appendix 13.1, Table 13. While this could be interpreted as a fear of the incumbent’s reaction, the evidence we received did not tend to argue that there were risks in rivals’ responses to entry, and the responses may have simply been due to the fact that competition from particular rivals reduced the likelihood of winning.

Summary of findings on barriers to entry

13.136 In common with the commercial market, we find that there are some barriers to entry and expansion in the provision of tendered services, such as the sunk costs involved in establishing and enlarging operations (albeit that these are not found to be large) and bidding for contracts. However, there are reduced risks to the prospective entrant in that vigorous competition with other operators on the route is unlikely to arise, as there is less likely to be a significant overlap and there will be reduced incentive for responses to entry by incumbents generally, although there are examples of incumbents registering commercial services against entrants on tendered routes. The evidence that incumbents enjoy advantages in winning
renewed contracts is mixed and it is not possible to separate the possibility of an incumbency advantage from the possibility that such results merely reflect the competitive advantages of particular operators.

13.137 This suggests that the constraint from entry will, to some extent, limit any potential for problems from a lack of competition being realized in the tendering of supported services. However, we note that aspects of tender design identified in paragraphs 13.117 to 13.119, including excessively complex and burdensome procurement practices, will also potentially act as a deterrent to new entrants. Although some of these deterrents could be addressed if there were a bundle of contracts or a large contract of sufficient size and duration to attract entry on the basis of developing a new base (subject to our observations on responses by incumbents), but this would deter bids from smaller operators or operators nearby looking for incremental growth. Thus, tender design can have both positive and negative effects on the likelihood of entry and its strength as a constraint.

Coordination

13.138 We considered whether there was any evidence of coordination in the market for the tendering of supported services, ie competition in the market for tenders may be limited if operators do not actively seek to compete with each other. Competitive pressures could be reduced if operators adopted bidding strategies where, for example, they chose to specialize in particular types of contract or to serve only particular geographic areas. If other operators also adopted a similar strategy, the consequence could be a reduction in the level of competition for particular contracts, and this situation might be sustained over time if operators realized that it was in their interests to maintain this approach so as not to induce a competitive reaction from rivals.

13.139 There were some concerns raised with us that Large Operators were not encroaching on each other’s territories, although it was not clear whether this was a deliberate policy of avoiding competition or whether it was a consequence of industry structure. We note our findings on geographic segregation in paragraphs 11.31 and 11.48 to 11.51. In relation to competition for tendered services Metro (West Yorkshire ITA) for example told us that the ‘territorial nature of the bus market means that the larger groups do not compete with each other for the operation of services in another’s area’ (Appendix 13.1, paragraph 29). TfGM71 told us that it did not see any significant evidence that large incumbent operators in Greater Manchester were using the tender process to expand their network operations into areas covered by another large operator. In response to our questionnaires, 10 per cent of LTAs expressed a concern that certain operators chose not to bid, or did not bid competitively, for some types of contract (see Appendix 13.1, paragraph 137). This was generally expressed as being the result of operators respecting each other’s areas of operation, although LTAs also provided some operational reasons for operators not bidding (see Appendix 13.1, paragraphs 139 and 140).

13.140 However, we received no further substantive qualitative evidence of coordinated effects in tendered services. Generally operators (and LTAs) provided rational explanations of the way in which operators decided whether to bid. There was little support for the notion that the identity of other bidders would affect the likelihood of bidding, and LTAs emphasized the importance of Small Operators in driving competition in the tendered market (see Appendix 13.1, paragraphs 141 and 142).

71 TfGM response hearing summary, p6.
13.141 We used our quantitative analysis to look at whether the probability that an operator bids for a contract depends on who previously held the contract. Thus, if the larger operators were choosing not to encroach on each other’s areas of operation, we would expect that they would be unlikely to bid at tender renewal where a different larger operator is present. This is explored in Appendix 13.2, Analysis 2. This finds mixed results: some of the Main Operators are less likely to bid if particular rivals held the existing contract, but no effect is shown for some other rivals, while in some cases the presence of a particular incumbent from the Main Operators increases the probability that one of the other Main Operators will make a bid. We also see varying patterns of Main Operators being more or less likely to bid, depending on which other operators they face.

13.142 Consequently, the quantitative analysis does not provide evidence of a systematic pattern of the Main Operators choosing not to bid against each other. Patterns of bidding are more likely to reflect whether these operators have depots in particular geographic areas which could service these contracts, and so any limitations on competition are unlikely to be arising from coordination (except in so far as the location of depots might be influenced by geographic market segregation—see paragraphs 8.207 to 8.212). In so far as the Main Operators tend to serve different areas, it is likely that they will have a reduced tendency to bid against the other main rivals for tendered contracts.

13.143 Even if operators sought not to compete actively with each other, we have seen that many contracts receive multiple bids, and that LTAs are willing to award contracts to Small Operators. In addition, new entry is sometimes possible. Therefore, it seems unlikely that operators could adopt any coordinated behaviours as a long-run strategy without incurring some risk of being displaced by new and smaller operators who would be unlikely to share the same incentives to coordinate.

**Summary of findings on coordination**

13.144 We found little evidence to suggest coordination in bidding for tendered contracts and we found it unlikely that such behaviour would be a sustainable long-term strategy.

**Gaming**

13.145 Another concern LTAs raised was that operators might seek to take advantage of the tendered services system in order to attract public financial support for services that otherwise would have been run commercially. A variety of possible tactics were suggested, but the two main approaches identified were:

(a) to deregister all or part of a commercially viable service, or some off-peak journeys, in the hope of then winning a replacement tendered contract; and

(b) ending a tendered contract early in the hope of winning it again at retender at a higher price.

13.146 For these tactics to be worth pursuing, the operator would need to be confident that the LTA would consider the withdrawn services to be essential and so worthy of public support, and second, it would need to be confident that it had a good chance of winning the contract in competition with any other potential bidders.

13.147 As most contracts attract multiple bids, it is unlikely that an operator could expect to have much opportunity to game the system before being undercut by a rival bid. However, there could be some instances where a particular operator has a substan-
tial advantage over rivals that may afford some degree of protection. For example, this may occur for the last section of a rural route where no other operators have services nearby. The incumbent can then deregister the end of a route and bid for support to run the extra distance at much lower cost than a rival who would have to deploy services specifically for this purpose. Such situations may occur for additional off-peak services. Such instances might fall within the framework for de minimis contracts and so there is no likelihood of them being awarded to other operators.

13.148 There was relatively little concern or evidence produced of any gaming of the system by LTAs occurring in practice. Specific concerns about gaming were mentioned by 17 per cent of LTAs, and a further 23 per cent had a general awareness of the issue. Relatively few were able to provide specific examples of gaming that they had experienced.

13.149 We found it very difficult to determine whether particular service withdrawals could be considered as gaming. Many routes are a mix of profitable peak services and poorly patronized off-peak services which do not cover direct costs. Even if the route overall is profitable, the operator may either decide to withdraw some of the off-peak services as unviable commercially, or might take the view that these extra services are commercially justified as they add to the overall attractiveness of the route and contribute to its overall profitability (as it increases the options open to ticket holders). In such a case, it is not apparent whether deregistering these services could be considered as gaming.

13.150 Some LTAs said that gaming used to be a problem but it was now not as prevalent (see Appendix 13.1, paragraph 145), while others thought that though it went on, it was on a small scale. Operators told us that although LTAs may decide to offer a contract to operate a deregistered route, this was not guaranteed. Operators also told us that the long-term relationship with LTAs was very important to their business and they would not want to jeopardize this through short-term behaviours to take advantage of the tender system. LTAs felt that they would normally expect to be able to identify instances of repeated gaming behaviour.

13.151 Appendix 13.2, Analysis 5, Table 6, shows weak evidence that where an operator has terminated a tender early, the renewal price has increased (no effect is seen for deregistering a commercial route). However, we also found that the likelihood that the incumbent wins the contract is significantly reduced following early termination of the contract (see Appendix 13.2, Analysis 3, Table 4).

13.152 No significant effect on the likelihood of winning is observed for deregistration of a commercial route. Analysis 1, Table 2, indicates that withdrawal of a commercial service significantly stimulates the number of operators which would bid for a contract (presumably because they have some knowledge of the performance of the route and can make a better informed bid, or they see an opportunity to grow the route). This evidence shows that trying to game the system to secure tendered support is an uncertain and risky strategy because other operators are likely also to bid for the service, and hence the incumbent may well lose the route.

Summary of findings on gaming

13.153 We found that the evidence for any significant incidence of gaming was not strong. Gaming is only likely to be a viable tactic where the incumbent operator knows it faces very little potential competition, such as where it has some intrinsic advantage (eg being the only operator in an area in a position to service that contract efficiently). Where this occurs, it is likely to be a consequence of other factors which restrict competition.
Conclusions on the tendered market

13.154 In relation to competition for the tendering of supported services we conclude as follows:

- The effectiveness of the competitive process for the tendering of supported services is enhanced where there are a greater number of bidders. Actions which make bidding more attractive will increase the number of bidders and the intensity with which they compete in formulating their bids. However, the mere fact that there are more anticipated bidders will increase the intensity of competition as operators have to bid more aggressively in order to maintain a chance of winning the contract.

- The nature of some tendered services means that they will often be unattractive to many bidders, for example if they are limited services in remote rural areas or extensions to commercial services.

- Competition can be adversely affected if the structure of the local bus market is concentrated, i.e. if there are a limited number of bidders in a local area who could bid for the contract—see paragraph 13.59.

- However, barriers to entry into tendered services appear lower than for commercial services as post-entry competition and the time taken to bring a route to profitability are less likely to be relevant. Entry therefore is more likely to provide a potential constraint within the market although some barriers remain. Limitations on competition will persist in cases where entry is unlikely to occur, for example because aspects of tender design make entry unattractive. This might arise because of a lack of information, or if risks are perceived to be high. There are also indications of some possible instances of retaliation to entry (paragraphs 13.132 to 13.134).

- Aspects of tender design can reduce competition, as set out in paragraphs 13.117 and 13.118. We recognize that sometimes these actions are undertaken, for example, as a result of a need to achieve certain quality standards, mitigate cost and risk for the LTA, or facilitate a quick and cheap procurement process.

- Aspects of procurement practice and confusion over the interpretation and application of procurement directives can also reduce competition—see paragraph 13.119.

- We have not found coordination in the market for the tendering of supported services.

- Gaming, if it occurs, is a result of restrictions on competition in the market for other reasons and does not appear itself to be a cause of an impediment to competition.

13.155 Overall, we see that the market for the tendering of supported services works well in most instances, although there are some areas where competition is limited (see Appendix 13.1, Table 15). We conclude that competition for the tendering of local bus services in certain local markets is prevented or restricted by (a) the way LTAs design tender/procurement processes, as set out in paragraphs 13.117 to 13.119, and/or (b) the limited number of potential bidders in some local areas—see paragraph 13.59. One or both of these features can limit the number of operators bidding for the tender contract and the intensity with which operators compete for these tenders.
13.156 We note that tendered contracts can provide a lower-risk means of entry into the provision of local bus services and can support the survival of bus operators which can have pro-competitive consequences for the commercial market. However, the anticipated reductions in funding for supported services (see paragraphs 13.12 and 13.13), as well as hitting users of these services and potentially weakening some bus operators, also reduce the likelihood of tendered services providing a basis for entry into the commercial market.

13.157 We have considered the likely size of any adverse effect. This can be inferred from looking at the results of our econometric models to determine how revisions to tender design may increase the number of bidders, and what effect the increased number of bidders is likely to have on changes in tender prices. This consideration does not address whether reductions in competition will adversely affect aspects of quality. It is possible that the quality of tendered services provided (e.g., in the precise services run, the quality of vehicles used and so on) could be reduced in so far as these elements are not specified in the terms of the tender, but we have not evaluated whether any such effect is significant. We note that only a proportion of tenders will be characterized by aspects of design we consider problematic, that the coefficients attached to these aspects in determining the number of bidders are not large, and that the price effects identified refer to differences in the rate at which tender prices increase at renewal, not the absolute level of these prices. An estimate of detriment arising is, however, set out in Appendix 14.2.
14. Conclusions on the AEC and features

14.1 Under section 134(1) of the 2002 Act, we are required to decide whether ‘any feature, or combination of features, of each relevant market prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK or a part of the UK’. A feature for the purposes of section 134(1) of the 2002 Act can take the form of the structure of the market and/or conduct of any of the participants in the market, including customers.\(^1\) We can consider either individual features or a combination of features of a market. ‘Conduct’ includes any failure to act (whether or not intentional) and any other unintentional conduct.\(^2\)

14.2 In defining the market we considered separately the operation of local bus services and the tendering of supported local bus services. For the operation of local bus services, we defined the product market as the provision of local bus services with the possibility that some alternative forms of transport (such as tram and rail services) may be included in certain cases as set out in paragraphs 7.62 and 7.63. The framework for our analysis of geographic markets is explained in paragraphs 7.66 to 7.69, and our geographic market definition is set out in paragraphs 7.97 to 7.102.

14.3 We conclude (see paragraph 7.120) that the relevant market for the tendering of supported local bus services will include all operators capable of bidding for a tender.

14.4 We have found that there are features of relevant markets for the supply of local bus services which in combination prevent, restrict or distort competition. We have also found that there are features of relevant markets for the tendering of supported bus services which alone or in combination prevent, restrict or distort competition. We set out these findings below.

**Supply of local bus services—features and findings**

14.5 We found that competition in the markets for the supply of local bus services is prevented, restricted or distorted where a combination of the features identified described in paragraphs 14.6 to 14.9 has an AEC as described below.

14.6 The first feature is the existence of a high level of concentration in each relevant market. This refers to the extent of overlap between operators’ services causing high concentration at the level of passenger flows. For an AEC to arise in a relevant market, effective head-to-head competition has to be absent. High concentration can also refer to the limited presence of operators across a wider local area, but this is not a necessary condition for the feature to arise. In such cases, this indicates that the constraint from potential competition will be reduced, adding to the impact of the AEC. We have found that the local bus market is generally stable (see Appendix 6.5), and so high concentration (both in terms of particular flows and routes or wider local areas) will have persisted over a number of years. Highly concentrated market structures are explained by factors set out in paragraphs 11.34 to 11.39.

14.7 The second feature is the existence of barriers to entry and expansion. These barriers are:

\(a\) uncertain and potentially significant sunk costs of bringing a route to profitability (see paragraph 9.212);

\(^1\) See section 131(2) of the 2002 Act.

\(^2\) See section 131(3) of the 2002 Act.
(b) uncertain and potentially significant costs associated with entering on a route arising from the expectation that incumbent reactions on that route can result, such that head-to-head competition will not be sustained (see paragraph 9.213);

(c) uncertain and potentially significant costs associated with entering on a route arising from the expectation of post-entry retaliation by the incumbent on other routes (see paragraph 9.216);

(d) disadvantages for a potential entrant on a route where the incumbent has existing network strength (see paragraph 9.217);

(e) advantages for larger incumbents arising from an ability to offer more attractive multi-journey tickets than smaller operators, particularly where there is no effective multi-operator ticketing scheme available (see paragraph 9.217);

(f) the difficulty in finding suitable depots (see paragraph 9.218);

(g) disadvantages for a potential entrant associated with gaining fair and reasonable access to bus stations owned and operated by an incumbent operator (see paragraph 9.219); and

(h) 'cheap exclusion' engaged in by incumbents (see paragraph 9.220).

14.8 The third feature is how customers conduct themselves in deciding which bus to catch. There are two aspects of customer conduct. First, some customers commit to a particular operator by purchasing a single-operator multi-journey ticket. Second, customers place a high value on time saved and certainty, relative to other factors such as price or quality. This means that customers who are not already committed to an operator prefer to catch the first available bus when at the bus stop and to minimize waiting time (regardless of any differences in relative fares and service quality between operators). This is explained in paragraphs 8.49 and 8.50.

14.9 The fourth feature is operator conduct, by which operators avoid competing with other operators in Core Territories, leading to geographic market segregation. This is explained in paragraphs 11.48 to 11.52. We have found that this conduct applies in relation to two operators in parts of the North-East of England, as explained in paragraph 14.20.

14.10 We have found that combinations of these features prevent, restrict or distort competition in two ways as described below.

14.11 The first way in which AECs arise derives from the first three features described in paragraphs 14.6 to 14.8. If a flow is highly concentrated, an operator will not face effective head-to-head competition against its services. In addition, the constraints from potential competition and new entry are restricted by the barriers to entry and expansion that we have identified. Potential competition may also be further weakened if the wider local market is highly concentrated. Customer conduct contributes to this outcome in that competition can take forms as described in paragraph 11.46. This creates or reinforces barriers to entry and expansion, and may be a cause of high concentration.

14.12 In the absence of these market features, we would expect that local bus operators would compete such that there was more head-to-head competition on a route or on flows, and/or the threat of potential competition and new entry would act as a stronger constraint.
14.13 In addition to the first three features, we have found a fourth feature, (d), to be present in parts of the North-East of England relating to the conduct of Arriva and Go-Ahead. This also gives rise to an AEC in a further way. Where all four features apply, geographic market segregation has diminished head-to-head competition and so caused high market concentration. This conduct also reduces the strength of potential competition, as the parties concerned are less likely to enter in head-to-head competition with existing services than they otherwise would. This prevention, restriction or distortion of competition also requires barriers to entry and expansion to be present, as otherwise this geographic market segregation could be undermined by new entry or expansion.

**Presence and extent of adverse effects**

14.14 We have found that competition in the markets for the supply of local bus services is prevented, restricted or distorted where a combination of the features identified below has an AEC.

14.15 We have found that at least some barriers to entry and expansion are present in all local markets in the reference area. This is explained in paragraphs 9.206 to 9.209. Therefore, it follows that potential competition and new entry will both be weakened as constraints on incumbent operators, at least to some degree, across the reference area.

14.16 We find that the feature on customer conduct applies across the reference area—see paragraph 11.44.

14.17 We find that head-to-head competition across the reference area is uncommon (see paragraphs 8.16 and 8.17). Therefore we find that the feature of high concentration, although not present in every market, is present in many markets—see Appendix 8.1.

14.18 Given that we consider the feature of customer conduct is present in every market, and there are barriers to entry and expansion in every market, we have found that competition is prevented, restricted or distorted in any market which is highly concentrated. In Section 11, we set out our analysis and identify the markets which are highly concentrated and therefore where there can be said to be an AEC. In paragraphs 11.64 to 11.85 we set out our approach to determining the degree of concentration at the flow level, although the analysis is based on routes. We find that only a few routes face head-to-head competition for all or nearly all of their passengers. Although almost all routes overlap with another operator's route at some point, approximately half face such limited overlap that they will not face effective head-to-head competition, and on many of the remaining routes a large proportion of passengers are unlikely to have a choice of operator.

14.19 This assessment also takes account of a number of factors in addition to the degree of head-to-head competition on a route, including: possible competition from a rail or tram service (see paragraphs 11.65 and 11.66); routes that might be served by a single vehicle (see paragraphs 11.68 to 11.71); and supported services where we would not normally expect there to be opportunities for a viable commercial service (see paragraphs 11.72 to 11.76).

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3 Because barriers to entry and expansion mean that potential competition and new entry are not fully effective competitive constraints, it follows that competition is prevented, restricted or distorted where head-to-head competition is not effective, ie where a market is highly concentrated.
14.20 We have found that the AEC in relation to operator conduct leading to geographic market segregation applies to the conduct of two operators, Arriva and Go-Ahead, in certain areas in the North-East of England. However, aspects of this conduct have been seen elsewhere and we remain concerned over the possibility that such conduct may be more widespread—see paragraphs 8.260 to 8.262.

Tendering of supported services—features and findings

14.21 We have found that competition in the market for the tendering of supported local bus services is prevented, restricted or distorted because the number of operators bidding for the tender contract and the intensity with which operators compete for these tenders is limited by one or both of the following features:

(a) the way LTAs design tenders, as set out in paragraphs 13.117 to 13.119; and

(b) the limited number of potential bidders in local areas—see paragraph 13.59.

Conclusion on the AEC and features

14.22 We therefore conclude, on the statutory question that we have to decide pursuant to section 134(1) of the 2002 Act, that there are adverse effects on competition within the meaning of section 134(2). The features are those that we identify in paragraphs 14.6 to 14.9 and 14.21.

Detrimental effects

14.23 We considered the nature and extent of detrimental effects on consumers that may be expected to result from the adverse effects on competition we have identified. Detrimental effects are defined in the 2002 Act as: ‘(a) higher prices, lower quality or less choice of goods or services in any market in the United Kingdom (whether or not the market to which the feature or features concerned relate); or (b) less innovation in relation to such goods or services’.

We considered detrimental effects on the end-consumer of local bus services and in relation to central and local government support for bus services we consider the effect on the taxpayer.

14.24 Where competition is weakened so that operators are not forced to compete to attract customers, we expect that in many places market outcomes will result in a detriment to consumers. In these areas, incumbent bus operators are able to reduce the quality of service they offer to customers (through shorter hours of operation and less frequent services, or otherwise lower quality or reliability of services), or increase fares above the level that would otherwise apply. Higher fares may also increase the costs of concessionary fare reimbursement. Bus operators may also be able to withdraw some less profitable services altogether in areas where they face little competition. Reduced competitive pressure may also result in reduced innovation in bus services and reduced pressure on operators to control costs and operate their businesses efficiently.

14.25 The effects of the AEC in respect of the tendering of supported services are reduced choice, reduced innovation, higher costs and/or lower quality of service for tendered services to the taxpayer.

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4 Section 134(5) of the 2002 Act.
We looked at whether the scale of detriment can be quantified. For some aspects of the detriment to consumers, quantification is difficult. In particular, it is difficult to measure the detrimental effects of reduced competition over time such as reduced innovation and reduced pressure on costs and efficiency (dynamic effects). However, it is possible to estimate some of the more static aspects of the detriment that arise such as the effects of high prices and some aspects of reduced service. We looked at two different estimates of the static detriment to consumers as a result of the AECs we have found in the operation of local bus services:

- an estimate based on the profits earned by the five Large Operators in excess of their cost of capital; and
- an estimate based upon the route level findings of the PCA (see Appendix 7.1) and the route categorization exercise set out in paragraphs 11.53 to 11.86 and Appendices 11.2, 11.3 and 11.4.

We also estimate the detriment as a result of the AEC that we have found in the tendering of supported services.

It was not practicable to perform an individual assessment of detriment for each relevant market within the reference area. We therefore provide an aggregated estimate of detriment as a result of the AECs in the reference area as a whole.

**Profits in excess of the cost of capital**

One way of inferring the general scale of detriment is by considering the extent to which profitability has been above the cost of capital. This analysis is set out in Section 10. This provides a measure of the profits that have been earned over and above those that would be expected in a competitive market, and thus can provide an indication of the detriment to consumers arising from features that prevent, restrict or distort competition. However, a profit-based measure of detriment will understate consumer harm as it measures only the transfer of welfare from existing consumers to producers. Where competition is restricted and outcomes for consumers are less attractive, some individuals will choose not to use the bus, for example because prices are too high, service levels low or because there is no service that suits their travel needs. These consumers suffer harm but there is no associated transfer of welfare to producers and so this harm will not be accounted for in a measure of excess profits. A profit-based measure of detriment may understate consumer harm further if a lack of competitive pressure leads to reduced efficiency in incumbent operators. We also note that our national profitability analysis covered the Large Operators only (comprising around 70 per cent of the reference area by revenue) and as such will underestimate the scale of profits in the industry if operators other than these five also make profits in excess of their cost of capital.

As noted in paragraph 10.89, we found that operators representing a substantial part of the market have earned profits that were persistently above the cost of capital on a national basis. We set out in Table 14.1 the profits the Large Operators have made in excess of the cost of capital mid-point of 9.7 per cent. This shows that the Large Operators as a whole made profits in excess of the cost of capital midpoint of £72 million per year in the five-year period between 2005/06 and 2009/10.

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5 Some additional aspects of detriment, relating to market expansion and demand creation effects, which will not be captured by profitability measures, are discussed in paragraphs 14.32 to 14.38.

6 This replaces the estimate of the benefit to passengers of an additional competitor based on the Urban-Area-level findings of the PCA and the results of the CC survey which was set out in Appendix 14.1 of the provisional findings.
### TABLE 14.1  Profits in excess of the cost of capital, 2005/06 to 2009/10

<table>
<thead>
<tr>
<th></th>
<th>Total (five-year period)</th>
<th>£'000</th>
<th>Average</th>
<th>Final year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arriva</td>
<td>[X]</td>
<td></td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>FirstGroup</td>
<td>[X]</td>
<td></td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>Go-Ahead</td>
<td>[X]</td>
<td></td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>National Express</td>
<td>[X]</td>
<td></td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>Stagecoach</td>
<td>[X]</td>
<td></td>
<td>[X]</td>
<td>[X]</td>
</tr>
<tr>
<td>Total</td>
<td>359,914</td>
<td>71,983</td>
<td>96,198</td>
<td></td>
</tr>
</tbody>
</table>

Source: CC calculation of the Large Operators’ profits in excess of the mid-point of our cost of capital. Derived from Table 10.3.

14.31 Using the extremes of the range, 8.5 per cent and 10.9 per cent respectively, we obtain a range of estimates of the transfer of welfare from consumers to producers of between £50.8 million and £93.2 million per year.

*Some aspects of detriment not captured by a profitability measure*

14.32 In addition to the harm existing passengers experience, some prospective passengers are harmed because the poorer outcomes that are associated with a lack of competition mean that they will not use the bus at all. As mentioned in paragraph 14.29, this aspect of detriment is not captured in the profitability measure, but we can make some observations on the nature of this detriment. There are two elements of this harm.

14.33 First, high fares will cause some individuals not to use the local bus at all, or to use it less often than would be the case at competitive fare levels. This is part of the ‘deadweight loss’ associated with market power. We describe the change in total demand as a result of a change in the level of fares as ‘market expansion (or contraction) effects’.

14.34 We note that the scale of market expansion effects depend on the elasticities of demand. As noted in paragraph 8.6, we find that, because the elasticity of demand with respect to both fares and other aspects of the competitive offer is generally low, market expansion effects are relatively small. The econometric demand study found that the market elasticity of demand with respect to fares was −0.36, which was broadly consistent with other studies. The CC survey found short-run elasticities of demand with respect to frequency of between 0.12 and 0.29. DfT guidance regarding the concessionary fares scheme notes that demand would increase in response to an increase in frequency. A long-run service elasticity of demand of commercial passengers to a change in frequency of 0.66 is recommended.

14.35 The second element of harm to consumers will arise if demand at all fare levels is reduced, due to changes in other factors such as service frequency and quality. We describe the change in total demand, at all fare levels, as a consequence in changes in the local bus service as ‘demand creation (or destruction) effects’.

14.36 We note that some aspects of the competitive offer can affect the propensity of individuals to use the bus. For example, the econometric demand study showed that the propensity of individuals to use the bus is higher where individuals live within close proximity of a bus stop. This is shown in Table 14.2.
### TABLE 14.2 Demand for bus travel by walk time to bus stop

<table>
<thead>
<tr>
<th>Minutes</th>
<th>Elasticity of demand with respect to bus fares</th>
<th>Predicted share of all bus trips</th>
<th>Number of individuals</th>
<th>Share of sample</th>
<th>Propensity to travel by bus*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 6</td>
<td>−0.36</td>
<td>91.4</td>
<td>9,421</td>
<td>85.3</td>
<td>1.1</td>
</tr>
<tr>
<td>7–13</td>
<td>−0.38</td>
<td>7.5</td>
<td>1,146</td>
<td>10.4</td>
<td>0.7</td>
</tr>
<tr>
<td>14–26</td>
<td>−0.37</td>
<td>1.0</td>
<td>322</td>
<td>2.9</td>
<td>0.3</td>
</tr>
<tr>
<td>27–43</td>
<td>−0.33</td>
<td>0.1</td>
<td>67</td>
<td>0.8</td>
<td>0.1</td>
</tr>
<tr>
<td>44 or more</td>
<td>−0.55</td>
<td>0.1</td>
<td>74</td>
<td>0.7</td>
<td>0.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.1</td>
<td>11,050</td>
<td>100.0</td>
<td>1.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: A disaggregate Analysis of Demand for Local Bus Service in Great Britain (excluding London) using the National Travel Survey, L Nesheim and J Molnar, 2010, Table D3.

*The propensity to travel by bus is calculated as the predicted share of all bus trips divided by the share of sample. This gives a relative measure of the propensity of individuals within each group to travel by bus.

14.37 The econometric demand study also showed that the propensity of individuals to travel by bus was affected by the frequency of the service from their nearest bus stop, as shown in Table 14.3.

### TABLE 14.3 Demand for bus travel by frequency of local bus service

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Elasticity of demand with respect to bus fares</th>
<th>Predicted share of all bus trips</th>
<th>Number of individuals</th>
<th>Share of sample</th>
<th>Propensity to travel by bus*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 1 per day</td>
<td>−0.15</td>
<td>0.6</td>
<td>82</td>
<td>0.7</td>
<td>0.8</td>
</tr>
<tr>
<td>1 per day</td>
<td>−0.40</td>
<td>4.5</td>
<td>845</td>
<td>7.4</td>
<td>0.6</td>
</tr>
<tr>
<td>1 per hour</td>
<td>−0.37</td>
<td>15.5</td>
<td>2,753</td>
<td>24.0</td>
<td>0.6</td>
</tr>
<tr>
<td>1 per half hour</td>
<td>−0.38</td>
<td>35.7</td>
<td>4,350</td>
<td>37.9</td>
<td>0.9</td>
</tr>
<tr>
<td>1 per quarter hour</td>
<td>−0.34</td>
<td>43.7</td>
<td>3,449</td>
<td>30.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>11,479</td>
<td>100.0</td>
<td>1.0</td>
<td></td>
</tr>
</tbody>
</table>

Source: A disaggregate Analysis of Demand for Local Bus Service in Great Britain (excluding London) using the National Travel Survey, L Nesheim and J Molnar, 2010, Table D4.

*The propensity to travel by bus is calculated as the predicted share of all bus trips divided by the share of sample. This gives a relative measure of the propensity of individuals within each group to travel by bus.

14.38 This suggests that some of the improvements in the competitive offer, as a result of competition, such as increased numbers of services, are likely to result in demand creation effects. The effects on consumer welfare of demand creation effects are potentially large. In effect, this ‘better service’ increases the benefits both to existing customers and to new customers who therefore begin to use the bus or use it to a greater extent. Consequently the detriment to consumers as a whole, as a result of the AECs we have found, is likely to be in excess of the value of profits in excess of the cost of capital.

### Assessment of detriment based on the route-level PCA and the route classification exercise

14.39 In Appendix 14.1 we set out an alternative methodology for calculating the scale of the detriment to customers as a result of the AECs based on the findings of the route-level PCA and building on the results of the route classification exercise set out in paragraphs 11.53 to 11.86. This method has a number of advantages over a profitability-based measure as it measures directly the welfare implications of the change in frequency, as a result of restrictions in competition, identified by the PCA.

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By way of illustration, using a simple linear demand framework, the additional benefit to consumers of a 1 per cent increase in the willingness to pay of all consumers would be more than £89 million a year.
It also incorporates demand creation or destruction effects that are not accounted for in a profit-based measure.

14.40 Using this method, we estimate that the harm to consumers, as a consequence of the AECs in the operation of local bus services, is likely to be between £110 million and £295 million per year.

The impact of tender design on contract prices

14.41 The analysis discussed in Section 13 showed that some aspects of tender design can result in fewer bidders for a contract. We also find that the number of bidders for a contract can affect contract prices and that contract prices are lower, all else equal, where there are more bidders for a contract.

14.42 We used a combination of the results from the econometric analysis set out in Appendix 13.2, and information from the qualitative survey of LTAs, to estimate the impact on contract prices for tendered services arising from particular aspects of tender design. Our calculations are set out in detail in Appendix 14.2. We estimate that if LTAs changed some aspects of their tender design so as to encourage more bidders, they could save between £5 million and £10 million a year in spending on tenders.

Summary of detriment

14.43 The results of our profitability analysis show that the overall detriment as a result of the AECs that we have found is in excess of £72 million a year. However, this estimate does not take into account a number of important elements of consumer detriment, in particular the dynamic effects of competition and demand creation or destruction effects.

14.44 The analysis set out in Appendix 14.1 provides a more direct assessment of the welfare implications of a change in frequency, as a result of restrictions in competition in the operation of local bus services. This analysis uses the results of the PCA and takes into account demand creation (or destruction) effects. It indicates that the detriment to customers as a result of the AECs in the operation of local bus services is likely to be between £110 million and £295 million per year.

14.45 We consider that the detriment to taxpayers as a result of the AEC in the tendering of supported services only (through higher costs of support) is between £5 million and £10 million a year.

14.46 Overall we therefore find that the detriment to consumers and taxpayers as a result of the AECs that we have found in the operation of local bus services (both commercial services and tendered services and the tendering of supported services) is considerably in excess of £72 million a year and is likely to fall within the range of £115 million to £305 million a year.
15. Remedies

Introduction

15.1 We now consider measures to remedy, mitigate or prevent the AEC, or resulting detrimental effects on customers, as set out in our findings and conclusions summarized in Section 14 of this report. This section describes our consideration of evidence relating to each individual element of the remedies package and to the remedy package taken as a whole, and sets out our decisions on remedies.

15.2 This section is structured as follows:

(a) First, we summarize the framework for consideration of remedies and relevant customer benefits (RCBs) (see paragraphs 15.3 to 15.8).

(b) Second, we discuss the remedy options that we have decided should form part of our remedy package (see paragraphs 15.11 to 15.432).

(c) Third, we discuss the other remedy options that we have considered (see paragraphs 15.433 to 15.484).

(d) Fourth, we consider whether there are any RCBs arising from the features giving rise to the AEC which would be lost by introducing our remedy package and if so whether we should seek to ensure that we retain any such benefits by modifying our remedy package (see paragraphs 15.485 to 15.493).

(e) Finally, we assess the effectiveness and proportionality of the remedy package (see paragraphs 15.495 to 15.589).

Framework for consideration of remedies and relevant customer benefits

15.3 Having found that there are features of local bus markets that give rise to an AEC, the CC is required to decide the following additional questions:

(a) whether action should be taken by the CC for the purpose of remedying, mitigating or preventing the AEC concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the AEC;

(b) whether the CC should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the AEC concerned or any detrimental effect on customers so far as it has resulted from, or may be expected to result from, the AEC; and

(c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

15.4 A detrimental effect on customers is defined as one taking the form of:

(a) higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or

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1 In this section, for the purposes of exposition, we use the phrase ‘the AEC’ to refer to the various adverse effects on competition summarized in Section 14. Where we wish refer to a specific adverse effect, we make this clear in the relevant context.
2 Section 134(4).
3 Section 134(5). The reference to customers includes future customers.
(b) less innovation in relation to such goods or services.

15.5 Whether action should be taken involves consideration both of the action the CC might take and the action the CC might recommend others to take. Whether taking action itself or making recommendations to others, the CC will state the action that should be taken and what it is designed to address. In practice, the CC may decide to take several discrete actions itself and/or make several discrete recommendations. This combination of measures is often referred to as a package of remedies.

15.6 The 2002 Act requires the CC, in considering these questions, ‘in particular to have regard to the need to achieve as comprehensive a solution as is reasonable and practicable to the adverse effect on competition and any detrimental effects on customers so far as resulting from the adverse effect on competition’.4

15.7 In deciding the question of remedies, the CC may ‘in particular have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned’ (see paragraphs 15.485 to 15.493 below).5

15.8 When deciding on an appropriate remedy, the CC will have regard to the effectiveness of different remedies and their associated costs and will have regard to the principle of proportionality.6

Remedy options that we are taking forward

15.9 In paragraphs 15.11 to 15.428, we discuss the remedy options that form our preferred remedy package. We have decided to take action ourselves and/or recommend action be taken by others in relation to the following areas:

(a) ticketing (see Figure 15.1 and paragraphs 15.11 to 15.109);
(b) operator behaviour (see Figure 15.2 and paragraphs 15.110 to 15.221);
(c) access to bus stations (see Figure 15.3 and paragraphs 15.222 to 15.290);
(d) supported services (see Figure 15.4 and paragraphs 15.291 to 15.339);
(e) effective competition enforcement (see Figure 15.5 and paragraphs 15.340 to 15.372);
(f) partnerships (see Figure 15.6 and paragraphs 15.373 to 15.422); and
(g) BSOG (see Figure 15.7 and paragraphs 15.423 to 15.428).

15.10 For each of these remedy options, we discuss:

(a) a summary of our decisions in relation to the remedy option;
(b) how the remedy addresses the AEC and/or resulting customer detriment;
(c) the key considerations relating to the design of the remedy option; and
(d) how the remedy should be implemented.

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4 Section 134(6).
5 Section 134(7).
**Ticketing**

*Summary of remedy*

15.11 Figure 15.1 summarizes our remedy in relation to ticketing.

**FIGURE 15.1**

**Summary of ticketing remedy**

We have decided, given our view that effective multi-operator ticket schemes are likely to reduce barriers to entry and expansion and thus stimulate competition among bus operators to the benefit of passengers, to recommend that:

- The Secretary of State for Transport (following consultation with the Welsh Government) and the Scottish Government introduce legislation to give LTAs additional powers to introduce mandatory multi-operator ticketing schemes that have the following characteristics:

  (a) **Governance:** Decisions about the design of a multi-operator travelcard (MTC) scheme should be taken together by operators and LTAs. In paragraph 15.41 we set out principles for a balanced set of governance arrangements in which all stakeholders’ interests can be taken into account, without any individual stakeholder having a disproportionate level of influence.

  (b) **Access to schemes:** In paragraph 15.43 we set out principles ensuring that new entrants are able to participate in local multi-operator schemes upon commencing the supply of local bus services in an area.

  (c) **Bus-only schemes:** As set out in paragraph 15.44, there should normally be a bus-only MTC as part of any MTC scheme. This can sit alongside any multi-modal products that are also offered.

  (d) **Zonal coverage:** For MTC schemes covering larger Urban Areas or conurbations, consideration should always be given to introducing ticketing products for smaller zones. The precise delineation of zones in MTC schemes should be determined locally in light of practical considerations and the principles set out in paragraph 15.45.

  (e) **Ticket types available:** As set out in paragraph 15.46, MTC schemes should have ticket types that broadly correspond to the main ticket types offered by individual operators.

  (f) **Availability and promotion of tickets:** MTCs should generally be made available to passengers through the same channels as single-operator multi-journey tickets, including on-bus. In paragraph 15.47, we also set out principles that should govern the promotion of MTC tickets.

  (g) **Pricing:** Prices of MTCs should be determined by reference to the framework set out in paragraphs 15.48 to 15.50.

- We recommend that LTAs use their statutory powers (including the additional powers set out above) and work with operators to introduce new MTC schemes and to reform existing schemes in line with the principles set out above.

- Pending the new legislation that we recommend introducing, we recommend that the Secretary of State for Transport (following consultation with the Welsh Government) and
the Scottish Government develop best practice guidance, based on the principles set out above, and monitor the progress of LTAs and operators in delivering new schemes and reforming existing schemes in line with these principles (see paragraph 15.108).

- The OFT reviews, at the earliest possible opportunity, the Public Transport Block Exemption (Ticketing Block Exemption) in relation to:
  
  (a) the revenue-sharing arrangements that are acceptable for multi-operator individual ticket (MIT) schemes;\(^7\) and

  (b) the types of e-purse schemes\(^8\) that are acceptable under competition law.

- The Secretary of State for Business, Innovation and Skills makes any changes to the Ticketing Block Exemption that are necessary in light of the OFT recommendations (see paragraphs 15.89 to 15.92).

- As part of its current review of BSOG in England, the DfT considers ways of incentivizing development and participation in effective multi-operator ticketing schemes (see Figure 15.7 in paragraph 15.443). This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

**How this remedy addresses the AEC and/or resulting customer detriment**

15.12 The series of measures summarized in Figure 15.1 addresses aspects of the AEC in relation to both the supply of local bus services and tendering for supported services. We discuss how these measures address the AEC in relation to the supply of local bus services in paragraphs 15.13 to 15.17 and Appendix 15.1. We discuss how these measures address the AEC in relation to tendering for supported services in paragraphs 15.18 to 15.21.

- **Supply of local bus services**

15.13 Our primary aim in relation to this remedy option is to substantially reduce the barriers to entry and expansion associated with network effects (see paragraphs 9.66 to 9.105), thereby promoting competition among bus operators and addressing high levels of concentration. The mechanism by which this aim is achieved is by increasing the proportion of passengers using multi-operator tickets through increasing the number and/or attractiveness of schemes. This, in turn, increases the proportion of passenger journeys (and hence revenue) that are contestable for a new entrant or expanding operator.

15.14 In Appendix 15.1, paragraphs 3 to 16, we set out our assessment of how an increase in the usage of multi-operator tickets reduces barriers to entry. In Section 8 we defined two forms of network effects, between-route\(^9\) and within-route\(^10\) effects. We find that this remedy is likely to reduce the impact of barriers to entry and expansion arising from between-route and within-route network effects. As a result of the

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\(^7\) MIT schemes are multi-operator ticketing schemes under which two or more different operators provide services which can be used to make a particular journey and ticket holders can choose whichever service they use to make part or all of that journey.

\(^8\) An electronic purse (e-purse) product from which money is deducted for each journey.

\(^9\) Where customers travelling on more than one route in a network are likely, all else being equal, to prefer a season ticket offered by an operator with more bus routes in the area (see paragraph 8.55).

\(^10\) Where, at a given price, customers are likely to prefer a return or season ticket offered by the operator with the greatest frequency or comprehensiveness of service on a route (see paragraph 8.54).
remedy, a small-scale, incremental entry or expansion strategy is more likely to be viable.

15.15 We find that between-route effects are more likely to be present in large and/or more complex bus networks (see paragraph 9.80). As set out in paragraphs 13 to 16 of Appendix 9.1, within-route effects are likely to be present on almost all routes at least to some degree, but are strongest on those routes with both a relatively high proportion of revenue accounted for by single-operator multi-journey tickets and a relatively high frequency of service. We find that larger Urban Areas tend to have more routes characterized by relatively strong within-route effects. Rural areas on average have fewer high-frequency services, and so overall are less likely to be characterized by strong within-route effects. However, some individual routes in rural areas may still be characterized by relatively strong within-route effects.

15.16 In Appendix 15.1, paragraphs 17 to 21, we also consider the impact of increased multi-operator usage on another barrier to entry and expansion: the expected intensity of post-entry competition and the associated tendency for head-to-head competition not to be sustained (see paragraphs 8.93 to 8.101 and 9.33 to 9.57). We found that increased multi-operator ticket usage could have a variety of possible effects on this barrier to entry and expansion and that the overall impact would be affected by the interaction with other measures in the overall package of remedies (in particular, those relating to operator behaviour—see Figure 15.2). Taking all of these possible effects together, we concluded that the incentive on operators to increase frequency in response to competition would remain, but that the overall tendency of head-to-head competition towards overcapacity is likely to be diminished, and that a small-scale, incremental entry strategy is more likely to be viable. In these ways, we expect this remedy, in combination with other measures, to reduce barriers to entry and expansion associated with the expected intensity of post-entry competition.

15.17 We recognize that multi-journey tickets (including single-operator multi-journey tickets) give rise to benefits for passengers. These include the discount for extra journeys compared with the sum of single fares, the convenience of not having to pay with cash on every boarding, as well as reduced boarding times. Multi-operator ticketing preserves and enhances these passenger benefits, as customers purchasing multi-operator multi-journey tickets are still able to obtain a discount for regular travel and are likely to experience increased convenience benefits. In addition, we have found that an increase in competition is associated with an increase in overall frequency of service (see paragraphs 7.35 to 7.37), though this overall frequency is split between a larger number of operators. Multi-operator tickets allow passengers to benefit more straightforwardly from this increase in overall frequency of service as they allow passengers to board any operator’s buses using a single ticket.

- Ticketing issues in tendering for supported services

15.18 We have found that the nature of some tendered contracts makes them less attractive for bidders, and hence an LTA receives fewer bids for these contracts. This in turn is likely to lead to higher prices. Some of those less attractive contracts include extensions of commercial services, for example into the evening or on Sundays (see paragraph 13.154).

15.19 We have heard from a number of LTAs\textsuperscript{11} that commercial extension contracts were often more attractive to the incumbent commercial operator, since that operator’s

\textsuperscript{11} Nottingham City Council response hearing summary, paragraph 19; Cornwall Council; ATCO response hearing summary, paragraph 12; TfGM response hearing summary, paragraph 11; SEStran response hearing summary, paragraph 9.
return or other multi-journey tickets were usually accepted as part of the contract terms. For example, on a tendered evening extension to a commercial service, the operator of the tendered contract might be required to accept the commercial operator’s return, day or longer duration tickets. LTAs often require tendered operators to accept commercial operators’ multi-journey tickets, as otherwise passengers would have to buy more than one ticket, or buy repeat single tickets, resulting in higher prices and reduced convenience (see paragraphs 13.91 to 13.96).

15.20 Accepting the commercial operator’s multi-journey tickets will not be a deterrent for bidding for a gross cost contract but the LTA (and hence the taxpayer) would in effect pay for the reduced revenue associated with accepting the commercial operator’s tickets. For a net cost contract (ie where the tendered services operator bears the revenue risk), unless the tendered services operator is reimbursed for accepting the commercial operator’s tickets, then the tendered services operator will be required to carry passengers who have bought these tickets in the day from the commercial operator but will not receive a share of this revenue. This will reduce the attractiveness of bidding for such tenders for anybody other than the commercial operator and will thereby reduce competition for the tender. A reduction in competition for tenders to run supported services will tend to make the winning bid price higher and lead to greater LTA (and hence taxpayer) expenditure on tendered contracts.

15.21 An increase in the usage of multi-operator tickets would mitigate this problem. If the multi-operator ticketing scheme includes effective methods for revenue distribution, then an operator of a tendered evening service extension will not be disadvantaged from carrying multi-operator ticket holders, as it would be for single-operator ticket holders. Therefore an increase in the usage of multi-operator tickets, whether area-specific or route-specific, is likely to increase the number of bidders for commercial extension tendered contracts, all else equal, and to reduce the costs of these contracts to the public purse. The extent to which this increases the number of bidders for such contracts will depend on the size of the increase in usage of multi-operator tickets and on whether there are any other factors making such contracts less attractive.

Design issues

15.22 In paragraphs 15.23 to 15.82, we set out the evidence and analysis relevant to the design of this remedy. Our consideration of this remedy takes place against the statutory and competition law framework that currently applies to ticketing schemes as set out in Appendix 12.1, Annex A.

15.23 We consider the appropriate remedy design for different types of ticketing arrangements, in particular:

(a) Urban-Area-level MTCs (see paragraphs 15.24 to 15.56 and Appendix 15.2);

(b) route-level schemes (see paragraphs 15.58 to 15.64); and

(c) smart ticketing arrangements (see paragraphs 15.65 to 15.82).

• Urban-Area-level MTC schemes

15.24 MTCs entitle ticket holders to make multiple journeys on a number of different operators’ services across a number of different routes. The Ticketing Block Exemption allows this type of scheme provided that these routes and services are not substantially the same (for at least three substantially different routes and services).
15.25 We consider first the scope for increasing the number of MTC schemes (paragraphs 15.26 to 15.35), we then review the evidence on the effectiveness of existing MTC schemes (paragraphs 15.36 and 15.37) and then discuss the characteristics of an effective scheme (paragraphs 15.38 to 15.51).

- **Increasing the number of MTC schemes**

15.26 We considered the scope for increasing the number of MTC schemes, including the types of area for which the introduction of such schemes is most likely to be beneficial.

15.27 The Large Operators emphasized the importance of introducing MTCs only where it would be proportionate to do so, although there is some variation on the degree of support for introducing further schemes among the Large Operators. FirstGroup also told us that it was considering introducing schemes in Bristol and Swansea. Most Small and Mid-Sized Operators had fewer comments on where there should be additional schemes, although Lothian Buses suggested that schemes should only be recommended for those local areas where they would alleviate the detrimental effects of an AEC and the Association of Local Bus Company Managers (ALBUM) said that multi-operator tickets should be recommended only where they were expected to be beneficial.

15.28 Passenger Transport Executive Group (PTEG), Transport for Greater Manchester (TfGM) and Luton Borough Council all suggested that MTC schemes would be more likely to be beneficial or proportionate in larger and/or urban areas. Aberdeenshire Council suggested that multi-operator schemes could be beneficial in all local areas, including rural areas (it was not specific about whether this applied to MTC schemes or any multi-operator ticketing agreement). Other LTAs did not comment on where multi-operator ticketing schemes should apply.

15.29 In Appendix 9.2 (paragraphs 2 to 14 and Annex A), we summarize the evidence on the MTCs (both voluntary and mandatory schemes) that are in existence throughout the reference area. We distinguish between those travelcard schemes that encompass a number of Urban Areas and those that correspond to individual bus networks. The former are generally less likely to be viewed by passengers as a substitute to single-operator tickets, which largely correspond to individual bus networks.

15.30 In Appendix 9.2 we also present evidence on the number and proportion of Urban Areas without an Urban-Area-level MTC scheme; with only a wider-area MTC scheme; and without any MTC scheme. This shows that the majority of Urban Areas have no Urban-Area-level MTC scheme, and even among the 60 largest Urban Areas, only 35 per cent have an Urban-Area-level MTC scheme and 33 per cent have no travelcard scheme at all (ie not even one covering a wider geographic area).

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12 Stagecoach highlighted three areas (Aberdeen, Dundee and Hull) where a scheme did not currently exist (Stagecoach response hearing summary, paragraph 14); Go-Ahead argued that in many local markets there would be limited (if any) demand for multi-operator tickets (Response to Remedies Notice, paragraph 2.3); Arriva argued that the CC had not identified any demand for multi-operator schemes beyond those that already existed (Response to Remedies Notice, paragraph B5).

13 FirstGroup response hearing summary, paragraph 14.

14 Lothian Buses response to Remedies Notice, paragraph 25.

15 ALBUM response hearing summary, paragraph 10.

16 Response to Remedies Notice: PTEG, paragraph 8.1; Luton Borough Council, Issue 1a; TfGM said that the remedy was to be welcomed in urban areas such as Greater Manchester (paragraph 1.2.1).

17 Response to Remedies Notice.

18 This analysis is in Appendix 9.2, paragraph 4, Table 1.

19 A full list of our Urban Areas and the multi-operator tickets that apply to those areas is contained in Appendix 9.2, Annex A.
15.31 As an indication of the largest urban bus networks without MTC schemes, in Appendix 15.3, Table 1, we list those Urban Areas with a population of more than 150,000 in which there is neither an Urban-Area-level MTC scheme nor a wider PTE scheme that includes the Urban Area. In Appendix 15.3, we identify 16 other Urban Areas that are part of broader MTC schemes in the West Midlands, Greater Manchester or West Yorkshire, but where there is not an MTC, or zone within a wider MTC scheme, covering the individual Urban Area. The population of an Urban Area provides an indication of the potential demand for an MTC scheme as well as the likelihood of significant between-route network effects arising. The other indicators of competition and market structure presented in Appendix 15.3 are also likely to affect the benefits of introducing a ticketing scheme into an Urban Area.

15.32 In response to the provisional decision on remedies, a number of parties highlighted the need to establish sufficient demand for a scheme in order to justify its introduction.21 We agree with these parties, that the likely demand for an MTC is a relevant consideration when contemplating the introduction of an MTC scheme. We also agree that in some smaller Urban Areas, demand may not be sufficient to justify the costs of introducing such a scheme. However, we also note the evidence that take-up of single-operator multi-journey tickets is generally high (see paragraph 5.78), that customers value the ability to purchase a multi-operator ticket (see Appendix 9.2, paragraph 8) and that the costs of introducing a small scheme (or the incremental costs of reforming an existing scheme) can be very low. For example, a multi-operator scheme exists in Bath, an Urban Area with a population of 90,000, which involves very low costs of set-up and ongoing administration.

15.33 As set out in Appendix 9.2, paragraphs 7 to 14, the reasons why schemes do not exist in particular Urban Areas reflect a variety of local factors, including the views of local operators and/or the LTA. However, based on our assessment of the evidence on customer behaviour, we disagreed with certain Large Operators that a general absence of customer demand for an effective local multi-operator ticketing scheme was the main reason for the very small number of Urban Area level schemes that we have observed.

15.34 We conclude from the above analysis that there are many Urban Areas without MTC schemes, including some large Urban Areas as set out in Appendix 15.3. In these larger Urban Areas, the introduction of an effective MTC scheme is especially likely to result in a substantial reduction in barriers to entry and expansion associated with network effects, through the mechanisms set out in paragraphs 15.12 to 15.21. There are also likely to be some competition benefits from introducing MTCs in smaller Urban Areas.

15.35 In considering whether to introduce new MTC schemes, the relevant LTA would need to reach its own view on whether the benefits of introducing an MTC scheme in any individual Urban Area were likely to outweigh the costs (see Appendix 15.8 for a summary of the evidence on the costs and wider benefits of introducing an MTC). In weighing up the costs and benefits of introducing an MTC scheme, we would expect LTAs to have regard to the benefits that may be expected to arise from increased competition, resulting from the combination of reduced barriers to entry and expansion, lower concentration and the ability of passengers to be able to use a single ticket to travel on several operators’ buses.

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20 We note that in 291 towns and cities there exists a PlusBus ticket. PlusBus tickets are a form of MTC as they allow travel on any local bus service within a specified area. The widespread availability of these tickets illustrates the practicability of introducing multi-operator tickets into a large number of diverse areas. However, these tickets are available only when purchased as an add-on to a train ticket and we therefore do not include PlusBus further in our analysis (see Appendix 9.2, paragraph 6).

21 Response to provisional decision on remedies: FirstGroup, paragraphs 3.2 & 3.3; Go-Ahead, paragraphs 2.7–2.15.
Effectiveness of existing MTC schemes

15.36 As set out in Appendix 9.2, paragraphs 16 to 23, we found that where multi-operator schemes do exist, uptake of the tickets available under these schemes is generally low. The evidence, from both operators and LTAs, also shows that the take-up of multi-operator ticketing schemes by customers varies across different MTC schemes and across operators within a scheme, ranging from [less than 5] to [15–20] per cent of an operator’s revenue depending on the scheme and on the operator. It is striking that the West Midlands MTC scheme accounts for a much smaller proportion of National Express’s revenue than the proportion of other Large Operators’ revenue accounted for by other PTE schemes (Manchester, West Yorkshire (Metro), South Yorkshire, Tyne and Wear and Merseyside), and somewhat lower (though the difference is less marked) than the [X] scheme.22 With the exception of the [X], the take-up of schemes outside PTE areas appears to be low.

15.37 Appendix 9.2, Table 4, sets out the characteristics of the existing MTC schemes about which we have comprehensive information.23 In our assessment of these schemes (see paragraph 9.115), we concluded that all of these MTC schemes have one or more of the following characteristics that are likely to limit their attractiveness to passengers and hence their take-up by passengers:

(a) There is no bus-only travelcard available, and so the only MTC available is a multi-modal ticket which is likely to be more expensive.24

(b) The travelcard covers only a wide area and does not have zones corresponding to individual bus networks. Again, this is likely to increase the cost of the MTC.25

(c) There is not a full range of ticket types available (for example, day, week, month tickets, or student tickets).26

(d) The travelcard is available for sale only off-bus (and often in a limited number of locations).27

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22 We note that these schemes all have different characteristics which might influence the take-up.
23 The Urban Area-level MTC schemes for which we do not have this information are the Leicester Flexi, the North Staffordshire smart (Stoke-on-Trent), the Southend-on-Sea Octopus, the Swindon Travelpass and Dayride, the Colchester Boroughcard and the Dumfries and Galloway Day Discoverer.
24 This is the case for the Network One scheme in Tyne and Wear, the Travelmaster scheme in South Yorkshire and the Kangaroo scheme in Nottingham. It is also currently the case in the ZoneCard scheme in Strathclyde, though SPT told us, following publication of the provisional decision on remedies, that it would seek to take forward the early interim development of a Bus-Only MTC in conjunction with the West of Scotland bus operators on the ZoneCard forum (SPT response to provisional decision on remedies, paragraph 2.1).
25 Looking at PTE schemes, for which this issue is likely to be most acute, the nBus scheme in the West Midlands, the System One scheme in Greater Manchester and the Metrocard scheme in West Yorkshire only offer tickets that allow travel across the whole PTE area, including a number of distinct Urban Areas. By contrast, it is possible to purchase tickets for smaller zones in the Network One scheme in Tyne and Wear, the Solo scheme in Merseyside and the ZoneCard scheme in Strathclyde.
26 For example, it is not currently possible to purchase a day ticket for the Solo Scheme in Merseyside, the Metrocard scheme in West Yorkshire and the Local Mover scheme in Darlington. This is also the case in the ZoneCard scheme in Strathclyde, though SPT told us, following publication of the provisional decision on remedies, that it would seek to take forward the early interim development of a One-Day MTC in conjunction with the West of Scotland bus operators on the ZoneCard forum (SPT response to provisional decision on remedies, paragraph 2.1). In terms of ticket types, the Bath Rider scheme does not offer student tickets, despite the fact that the main operators which run services to the university offer such tickets. B&NES Council told us that, following publication of our provisional decision on remedies, it proposed to engage with local operators to amend the Bath Rider MTC in line with the principles we have identified for an effective scheme.
27 For example, no tickets are available on-bus in the Solo scheme in Merseyside, the Metrocard in West Yorkshire, the ZoneCard in Strathclyde and the One ticket in south-east Scotland.
15.38 In Appendix 15.2, we set out our analysis of the characteristics of an effective MTC scheme, drawing on evidence on existing multi-operator ticketing schemes. Here we summarize our conclusions on the following aspects of MTC design:

(a) governance (paragraphs 15.39 to 15.42);
(b) access to schemes (paragraph 15.43);
(c) bus-only schemes (paragraph 15.44);
(d) zonal coverage (paragraph 15.45);
(e) ticket types available (paragraph 15.46);
(f) availability and promotion of tickets (paragraph 15.47); and
(g) pricing (paragraphs 15.48 to 15.50).

- Governance

15.39 We would expect decisions about the design and operation of an MTC scheme to be taken by operators and LTAs, by voting where this is necessary.

15.40 We recognize that an effective governance structure needs to be able to balance the following two risks. First, an effective voting structure would not allow larger operators to block changes to a multi-operator ticketing scheme that would increase its popularity and thereby bring passenger benefits. Secondly, an effective voting structure would recognize the fact that larger operators have a greater financial exposure to the scheme and would be resilient to ‘gaming’ by smaller operators. There is potentially some scope for conflict between these two aims. In our judgement, the key to reconciling these two aims is to have a balanced set of governance arrangements in which all stakeholders’ interests can be taken into account, without any individual stakeholder having a disproportionate level of influence.

15.41 In light of these considerations, we took the view that the following governance and voting arrangements are likely to provide the basis for an effective scheme:

(a) Clear objectives for the scheme to which all participants have signed up: the primary objectives should be focused on providing good value and convenient multi-operator ticketing products to passengers. Such schemes may also grow demand for bus services. Other objectives are likely to include the following factors: ensuring that the schemes are viable for the operators; commitment of participants to abiding by the scheme’s rules; and the contribution that the scheme can make to delivering the Local Transport Plan.

(b) Where necessary, a third party administrator of the scheme, which could also handle commercially sensitive data (such as that used to calculate prices of the MTC) and manage revenue reimbursement. In existing schemes this role is often performed by the LTA. The extent and nature of any administration required will be affected by the size and complexity of the scheme.

(c) LTA representation on the board, including a vote in its own right (not as part of a block vote). This is for a number of reasons, including in recognition of the LTA’s financial interest in the scheme as the funding body of supported services and
some marketing and/or administration costs and its accountability for delivering Local Transport Plans. LTAs can also provide representation of passengers' interests. There may also be a role for passenger representation on the governance board, where the LTA and operators believe there is scope for it. In addition, LTA representation can help balance the twin risks of dominance by larger operators and potential concerns in relation to small operator gaming (see paragraph 15.42).

(d) Small operators should have a clear mechanism for representing their views on the scheme, either directly or as part of a voting ‘block’.

(e) No individual operator should have more than 49 per cent of the votes, which ensures that no operator is able to dominate the voting mechanism.

(f) Subject to this cap, operators’ voting rights should be apportioned on the basis of some broad measure of market share (such as registered mileage or weekly services). This need not be entirely pro rata—for example, operators with more than a certain share of the market may have an additional seat on the board. This reflects the greater financial exposure of larger operators to schemes and helps to manage the risk of ‘gaming’ by smaller operators.

(g) Decisions should be taken by a simple majority.

15.42 We have sought to establish the core principles of effective and well-balanced governance arrangements, rather than to specify every aspect of decision-making. There is a range of governance and voting arrangements that are consistent with these principles, and many important details will be best determined locally. Our detailed analysis and reasoning for this approach, including our consideration of the various representations by parties, is presented in Appendix 15.2, paragraphs 2 to 17).

- Access to schemes

15.43 A new entrant should be able to join an existing MTC scheme and sell the scheme’s tickets upon commencing supply of local bus services, provided it abides by the terms and rules of the scheme, and should be reimbursed for the multi-operator ticket passengers it carries according to the revenue reimbursement principles of the scheme. A new entrant should be able to participate in the governance of the MTC scheme, according to the governance principles of the scheme at the earliest practical opportunity (for example, the next meeting of the governance board). Our detailed analysis and reasoning for this approach, including our consideration of the various representations by parties, is presented in Appendix 15.2, paragraphs 18 to 20.

- Bus-only schemes

15.44 An MTC scheme should normally include a bus-only MTC. This can sit alongside any multi-modal products that are also offered. Our detailed analysis and reasoning for this approach, including our consideration of the various representations by parties, is presented in Appendix 15.2, paragraphs 21 to 24.

- Zonal coverage

15.45 For MTC schemes covering larger Urban Areas (or conurbations including several Urban Areas) consideration should always be given to introducing ticketing products for smaller zones within the Urban Area or conurbation. The precise delineation of
zones will be a matter to be determined locally, in light of a range of practical consider-
ations. However, we took the view that, as a guiding principle, such zones
should correspond broadly to the main zones available for the main single-operator
multi-journey tickets in the area, where these have been demonstrated to correspond
to a passenger demand for multi-journey tickets. Tickets should also be available to
cover the travel-to-work areas in and around particular Urban Areas: this may
necessitate cooperation between LTAs. Our detailed analysis and reasoning for this
approach, including our consideration of the various representations by parties, is
presented in Appendix 15.2 (paragraphs 25 to 31 and Annex A).

- **Ticket types available**

15.46 MTC schemes should have ticket types available broadly corresponding to the main
ticket types offered by individual operators, for example in terms of the time duration
of tickets (eg a daily or weekly travelcard), or discounts being available for certain
groups (such as children and students). MTC schemes should not be precluded from
developing innovative multi-operator products that are not available on a single oper-
ator basis, if there is likely to be customer demand for such products. Our detailed
analysis and reasoning for this approach, including our consideration of the various
representations by parties, is presented in Appendix 15.2, paragraphs 32 to 35.

- **Availability and promotion of tickets**

15.47 MTCs should generally be made available through the same sales channels as the
single-operator multi-journey tickets. Day tickets should generally be made available
for purchase on-bus. As a guiding principle, the availability of other ticket types (eg
weekly, monthly) on-bus should be consistent with the availability of equivalent
single-operator tickets on-bus. Individual operators’ marketing of tickets should not
discriminate against multi-operator tickets—for example, multi-operator tickets should
be referred to on operators’ websites and in published marketing materials alongside
information on single-operator tickets. A separate budget for marketing of scheme
products should also be considered. Our detailed analysis and reasoning for this
approach, including our consideration of the various representations by parties, is
presented in Appendix 15.2, paragraphs 36 to 40.

- **Pricing**

15.48 The price of an effective multi-operator ticketing scheme should be built up from
single fares, according to the following framework:

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Multi-operator ticket fare =
   average or median single fare
   x estimated ticket usage
   x discount for a multi-journey ticket.
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15.49 Using such a framework for pricing would increase the transparency of how prices of
multi-operator tickets are set and of the relevant information used to determine these
prices. This framework is not intended to be applied as a mechanistic formula, but to
be used as a way of facilitating decisions about an appropriate level of pricing. Such
decisions should be taken at a local level in accordance with the governance
arrangements discussed in paragraphs 15.41 to 15.44.

15.50 We received a large number of representations on this framework following publica-
tion of the provisional decision on remedies. Our detailed analysis and reasoning for
this approach, including our consideration of the many representations by parties, is
presented in Appendix 15.2 (paragraphs 44 to 78 and Annex B). In our judgement, this pricing framework establishes a principled, flexible and pragmatic framework to enable local operators and LTAs to establish the price of multi-operator tickets in the light of the best available evidence. Having reviewed the comments that we received on this framework, we concluded that it is sufficiently flexible to deal with the issues raised, while providing additional structure and clarity to decision-making about the price of multi-operator tickets.

- Preventing operators from offering single-operator multi-journey tickets

15.51 We considered whether restrictions on individual multi-operator tickets might also be necessary.

15.52 All of the Large Operators opposed restricting the ability of operators to offer their own multi-journey tickets, with most emphasizing that such restrictions would distort or restrict price competition and/or competition to innovate. Several LTAs also noted that restricting the ability of operators to offer single-operator tickets might mean that customers would have to buy more expensive products or reduce passenger choice. Stagecoach and Go-Ahead told us that any restrictions on operators’ own ticketing products (for example, a restriction on the price or a restriction on the ticket types that could be offered) would reduce the incentive on incumbent operators to compete on ticket prices and offer attractive ticket options.

15.53 Rotala, on the other hand, argued that only by restricting the incumbent operator’s own multi-journey tickets would a multi-operator scheme be effective and suggested that operators be required to price their own single operator tickets in accordance with the framework set out in paragraph 15.48. Its concern was in particular in relation to the West Midlands where it argued that barriers to entry associated with National Express’s (the large incumbent operator’s) multi-journey tickets were particularly strong. Three LTAs also argued that restricting the ability of operators to offer their own single-operator multi-journey tickets would be appropriate in order to increase the effectiveness of multi-operator tickets.

15.54 We took the view that restricting the ability of operators to offer their own individual multi-journey tickets would prevent operators competing on the price of multi-journey products and on competing to innovate with new multi-journey products. These aspects of competition can provide passengers with significant benefits in the form of lower prices, greater choice and more convenient tickets. We were therefore concerned that restricting these dimensions of competition could give rise to adverse effects that would outweigh the benefit associated with lowering barriers to entry and expansion and therefore preferred to focus on improving the availability and attractiveness of multi-operator ticketing products in order to address these barriers.

15.55 In response to our provisional decision on remedies, several parties argued that our framework for the pricing of MTCs set out in paragraphs 15.48 to 15.50 could act as a form of price control and thereby have a similar damaging effect on incentives to

28 Response to Remedies Notice: FirstGroup, paragraph 2.11; Stagecoach, paragraph 4.23; Arriva, paragraph D1; Go-Ahead, paragraph 2.28; National Express, paragraphs 3.39 & 3.40.
29 Response to Remedies Notice: Stagecoach, paragraph 4.23; Arriva, paragraph D1; Go-Ahead, paragraph 2.28; National Express, paragraphs 3.39 & 3.40.
30 Response to Remedies Notice: PTEG, paragraph 8.13; Nexus; SPT, paragraph 4.39; City of York Council, Comment 3 paragraph a; Luton Borough Council, Issue 3a; Cheshire West and Chester Council, paragraph f; Edinburgh City Council.
31 Stagecoach response to Remedies Notice, paragraph 3.14; Go-Ahead response to Remedies Notice, paragraph 2.28.
32 Response to Remedies Notice, paragraph 4a.
33 Rotala response hearing summary, paragraph 4; Rotala response to provisional decision on remedies, paragraphs 8–11.
34 Response to Remedies Notice: TFGM, pp2 & 3; SYPTE, p8; B&NES Council, p4.

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compete. Some parties also put to us that the application of the pricing framework could be inconsistent with the terms of the Ticketing Block exemption, for example by constraining the freedom of operators to set their own ticket prices.

15.56 We gave careful consideration to these and other arguments about the potential risks of our pricing framework (see Appendix 15.2, paragraphs 66 to 76).

15.57 We noted first that, under our remedy, operators would remain free to determine their own ticket prices. We acknowledge that individual operators are likely to have regard to the price of any local MTC products when considering their own pricing decisions. This is the case, however, whatever method is used to determine the price of an MTC. Given this, we judged the critical issue to be ensuring that the price of the MTC was set at an appropriate level, and we saw no reason to conclude that our pricing methodology would result in multi-operator ticket prices being set at an unrealistically or disproportionately low level (see Appendix 15.2, paragraphs 69 to 76). The pricing framework simply provides a structured and principled way of setting MTC prices, by reference to relevant local information. We considered the risks of dampening the incentive to compete on single ticket prices in Appendix 15.2, paragraphs 67 and 68, and concluded that the design of this measure limits the scope for any such effects to arise, and that any possible dampening of operators’ incentives to compete would be outweighed by the pro-competitive impact of this remedy in reducing barriers to entry and expansion. For these reasons, we did not agree that our pricing framework would damage operators’ incentive to compete on price, or otherwise be inconsistent with the terms of the Ticketing Block Exemption.

- **Route-level schemes**

15.58 In paragraph 15.15, we conclude that almost all routes exhibit within-route effects to some extent. Our analysis in Appendix 9.2 also shows that larger Urban Areas tend to have the highest proportion of routes with relatively strong within-route effects. However, there are likely to be some routes in smaller Urban Areas or rural areas that also exhibit relatively strong within-route effects. In such cases, a route-level multi-operator ticket would address these network effects and encourage competition on that route, while being less costly to implement than a travelcard scheme. In addition, a route-level scheme may increase competition in tendering of certain types of supported services (see paragraphs 15.18 to 15.21). Such route-level schemes could involve operators agreeing to accept each other’s multi-journey tickets, or might involve a separate multi-operator ticketing arrangement. To satisfy the definitions in the Ticketing Block Exemption, these route-level schemes would be considered to be MIT schemes (see Appendix 12.1, Annex A).

15.59 The Ticketing Block Exemption requires that revenue lies where it falls for MITs. Where operators sell a number of tickets roughly in proportion to passengers carried, this is likely to be a suitable, and low-cost, arrangement. However, in cases where there is an uneven distribution of ticket sales and passenger numbers across different operators’ services, revenue lying where it falls is likely to discourage operators from entering into such schemes. This is because where an operator carries more multi-operator ticket passengers than it sells multi-operator tickets, it does not receive reimbursement for all passengers carried, and hence it can be unattractive for that operator to participate in that scheme. One example where this occurs is where an

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35 Response to provisional decision on remedies: FirstGroup, paragraph 3.7; Stagecoach, paragraph 3.18; Lothian Buses, paragraphs 3.7–3.10.
36 Response to provisional decision on remedies: FirstGroup, paragraph 3.7(e); National Express, paragraphs 3.93 & 3.94.
37 We note that some route-level schemes might cross LTA boundaries, and so may be more likely to be initiated by operators,
evening or weekend service is operated by a different operator (often on a supported service) from the day peak-time services, where the majority of tickets are sold (see paragraphs 15.18 to 15.21).

15.60 OFT guidance on the Ticketing Block Exemption recognizes that revenue lying where it falls may not be suitable in the circumstances described above. However, the guidance is not very specific about what alternative revenue-sharing arrangements might allow such ticketing agreements still to come within the terms of the Block Exemption:

Although MIT schemes that use a different revenue distribution method do not meet the conditions of Article 15 and hence cannot benefit from the block exemption, the OFT considers that these schemes are likely to satisfy the conditions in section 9(1) of the Act … provided that the revenue distribution method is limited to what is necessary for the MIT scheme to work and does not result in the operators agreeing the price of the MIT.38

15.61 As set out in paragraph 15.19, a number of LTAs told us that commercial extension contracts were more attractive to the incumbent commercial operator in part because revenue in practice tended to lie where it fell. We were also told that the Ticketing Block Exemption limited the number of smaller multi-operator schemes (for example, route-level schemes that did not fall within the definition of an MTC within the Block Exemption guidance).39 In its response to the provisional decision on remedies, FirstGroup told us that there was no obligation on an LTA to include the requirement to accept return tickets as part of the tender specification and that these concerns were therefore misplaced.40

15.62 In our judgement, the current lack of clarity about what types of reimbursement arrangements are lawful is likely to create a barrier to implementing route-level schemes that could address the AEC that we have found. While we noted FirstGroup’s submission that it was open to LTAs not to require bidders for a supported service to accept other operators’ return tickets, we understood why LTAs would reasonably wish to include such specifications in tendered service contracts and why passengers would value the convenience this offered. The presence of an effective ticketing scheme, at the level of either the route or Urban Area, would enable LTAs to preserve both effective competition and the passenger benefits of being able to use convenient ticketing products.

15.63 We therefore concluded that it would be desirable for the OFT to review, at the earliest possible opportunity, the Ticketing Block Exemption in relation to the revenue-sharing arrangements that are acceptable for MIT schemes (see paragraphs 15.90 to 15.94). This would contribute to addressing or reducing the AEC that we have identified in both the commercial and tendered markets. In this context, we note that new technology (see paragraphs 15.63 to 15.82) may also facilitate the more accurate redistribution of revenue.

15.64 The Ticketing Block Exemption also precludes price-setting on MITs. The reason for this is because if operators come together to set the price of a multi-operator ticket on a single route where they overlap, this risks effectively removing price competition on that route. These schemes are not the same as travelcard schemes where oper-

39 SYPTTE response to Remedies Notice, paragraph 7f; TfGM response to Remedies Notice, paragraph 1.2.10.
40 Response to provisional decision on remedies, paragraph 3.31.
ators offer different, albeit overlapping, networks. For example, an MIT might involve operators agreeing to accept each other’s multi-journey tickets, and allowing price fixing in such a scheme would amount to fixing the prices of operators’ own multi-journey tickets. In the light of our conclusions in paragraphs 8.258 to 8.262 we share the OFT’s concerns about potential coordination and hence do not recommend any changes to the Ticketing Block Exemption to allow price-setting of route-level multi-operator schemes (MITs).

- **Smart ticketing**

15.65 The DfT and several LTAs argued that smart technology and associated ticketing products might facilitate the effectiveness of multi-operator schemes. Increased effectiveness could be delivered in various ways: by providing ticketing products such that customers do not have to pre-commit to a single-operator multi-journey product but can still realize the multi-journey savings (using capping technology),\(^{41}\) by delivering passenger benefits through increased convenience and quicker boarding times and thereby growing the market,\(^{42}\) and/or by facilitating better revenue redistribution.\(^{43}\) National Express also told us that smart ticketing would facilitate more accurate recording of passenger numbers.\(^{44}\)

15.66 Most of the smart technology rolled out to date across the bus fleet in the reference area is compatible with the ITSO specification, which is an open specification designed for transport ticketing.\(^{45}\) The roll-out of this technology is at different stages throughout the reference area:

(a) **England.** From 2009 to 2011, the DfT provided funding to the nine largest urban areas in England (outside London) to facilitate the introduction of ITSO smart technology on public transport. In addition, the DfT has provided incentives to roll-out the technology on to buses through BSOG. The roll-out of technology is at different stages throughout these nine areas.

(b) **Scotland.** All buses have been equipped with ITSO smart technology and this is used for the national concessionary fares scheme. This investment was publicly funded.

(c) **Wales.** All buses have been equipped with ITSO smart technology and this is used for the national concessionary fares scheme. This investment was publicly funded.

15.67 The technology to support smartcards has therefore been rolled out or is in the process of being rolled out in all of Scotland and Wales and in several regions in England.\(^{46}\) To date, relatively few areas have developed specific plans for multi-

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\(^{41}\) Centro response to Remedies Notice, p3. TfGM response to provisional decision on remedies, p14.
\(^{42}\) Response to provisional decision on remedies: TfGM, p14; Cheshire West and Chester Council, p1.
\(^{43}\) Centro response to Remedies Notice, p6; City of York Council response to Remedies Notice, comment 1, paragraph g; DfT response to provisional findings and Remedies Notice, paragraph 35; SYpte; TfGM response to provisional decision on remedies, p14.
\(^{44}\) National Express response hearing summary, paragraph 2.
\(^{45}\) Although we understand that in certain instances technology is compatible with EMV (a global standard for certain forms of payment cards) as well as or instead of ITSO standards.
\(^{46}\) Merseytravel assisted five small operators to equip their buses with ITSO-compliant technology and the larger operators were equipping their own fleets (Merseytravel response hearing summary, paragraph 10); Cornwall Council told us that it hoped to have the majority of technology in place by end of 2011 (Cornwall Council response hearing summary, paragraph 9); Metro told us that it acquired the back-office systems necessary to facilitate smart ticketing (Metro response hearing summary, paragraph 15); SYpte told us that operators in South Yorkshire were currently rolling out smart technology and that SYpte had the back-office technology (SYpte response hearing summary, paragraph 34); Centro told us that all buses in the West Midlands were equipped with smart technology, and that any new entrant would have the technology provided by Centro (Centro response hearing summary, paragraph 12).
operator bus tickets to be available for passengers using that technology: two PTEs are prioritizing the development of the technology on their light rail systems and several other authorities told us that at this stage developments were being made in terms of single-operator smart ticketing products before multi-operator products were developed. In response to the provisional decision on remedies, some parties highlighted practical obstacles and associated costs of developing multi-operator e-purse smartcard schemes (with or without capping technology), such as the potential complexity of such schemes and the need for a suitably regulated e-purse provider to reach commercial agreements with multiple parties. In response to the Remedies Notice, Luton Borough Council also emphasized the value of a simple paper-based system. We were made aware of developments towards multi-operator smart ticketing products in particular areas. Centro told us that it was in the process of introducing an e-purse card for the West Midlands and was working towards establishing a fare-capping regime to simplify ticketing for customers, and Merseytravel told us that its smartcard (the ‘Walrus’) would initially have a multi-operator ticket that would replace existing paper multi-operator tickets. In its response to the provisional decision on remedies, SPT told us that it was in the early stages of implementing a smartcard ticket and e-purse arrangement, initially for use on the Glasgow Subway and then to be used as a platform for a multi-modal and bus-only multi-operator travelcard. Notwithstanding these recent developments, smart technology appears to be currently more widely used for single-operator tickets and concessionary travel than for multi-operator tickets.

15.68 In addition to the beneficial effects for competition and passengers of paper-based multi-operator ticketing schemes, smart technology has the potential further to reduce barriers to entry associated with network effects. Smart technology is likely to facilitate more accurate revenue redistribution and estimates of ticket usage, which will contribute to a more efficient and effective scheme.

15.69 In addition, smart technology would enable an additional benefit of flexibility to passengers if capping to the best available fare is used. This would require an e-purse product from which money is deducted for each journey, and which can be used on any operator’s services where the prices is set (or capped at) the best available fare (whether this is a single- or multi-operator fare). Capping limits could also be set, for example, for a geographic area within a certain period (eg daily, weekly, monthly, annually).

15.70 In order to secure the competition benefits of this technology whilst retaining the ability for operators to compete on price and quality, we decided that, where smart ticketing products are developed, they should adopt the following broad approach to pricing (as was also advocated by the DfT):

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47 TfGM response hearing summary, paragraph 16; Nexus response hearing summary, paragraph 16.
48 Scottish Government response hearing summary, paragraph 10; Cornwall Council response hearing summary, paragraph 9; Metro response hearing summary, paragraph 15; Welsh Government response hearing summary, paragraph 15.
49 Response to provisional decision on remedies: Stagecoach, Annex 1, paragraph 7; Bath and North East Somerset, p2; Yellow Buses; FirstGroup, paragraph 3.37.
50 Response to Remedies Notice, Issue 1d and f. Luton Borough Council emphasized that the benefit of a simple paper-based system with revenue lying where it fell, which could be implemented quickly and would be easy to confirm, came within the terms of the Ticketing Block Exemption.
51 Centro response hearing summary, paragraph 12; Merseytravel response hearing summary, paragraph 10.
52 SPT response to provisional decision on remedies, paragraph 2.7.
53 For example, Trent Barton’s Mango products in Nottingham are available on smart technology (Nottingham City Council response hearing summary, paragraph 14) and NCT told us that ‘Lothian Buses’ own single-operator products (with the exception of its single tickets and day tickets) are smart tickets (Lothian Buses response hearing summary, paragraph 13); the Cardiff Bus Iff card uses smart technology.
54 Concessionary passes already use smart technology in Scotland, Wales and the West Midlands (see Centro response hearing summary, paragraph 12). In addition, SYPTTE told us that its priority was to implement smart technology for concessionary fares (SYPTTE response hearing summary, paragraph 34).
(a) **Single-operator cap.** If a customer travels on the services of only one operator, then there will be a cap on the total amount that can be deducted from their e-purse each day (or week), set by each individual operator. These might correspond to the single-operator multi-journey ticket levels in a paper-based ticketing system.

(b) **Multi-operator cap.** If a customer travels on the services of more than one operator, the cap on the total amount that can be deducted from their e-purse each day (or week) will be set at a different level, the multi-operator cap. The level of this cap should be set using the same principles as used for paper-based multi-operator tickets, as set out in paragraphs 15.48 to 15.50.

15.71 We concluded that capping to the best available fare in line with these principles would therefore give rise to the same benefits as non-smart multi-operator ticketing schemes. However, it would also give rise to an additional passenger benefit of increased flexibility and convenience. This is because passengers would not need to pre-commit to single-operator or multi-operator tickets in advance, but could rather make their choice when waiting at the bus stop, conditional on which operator’s service arrives. As such, we would expect uptake to be greater and the impact in reducing barriers to entry and expansion more substantial.

15.72 Some PTEs pointed out that there was currently no legislation that allowed LTAs to compel operators to participate in an LTA-led smart scheme, with PTEG and several PTEs arguing that these powers would be beneficial.55

15.73 Some PTEs also argued that there was likely to be a need for reform of the Ticketing Block Exemption to provide guidance on the development of revenue-sharing arrangements between operators in e-purse plus capping arrangements. In response to the OFT’s consultation on the Ticketing Block Exemption in 2010, the DfT argued that since smart ticketing enabled new ticketing products (such as the capping system outlined above), the Ticketing Block Exemption might require revision to provide guidance on appropriate revenue-sharing in such a setting. The DfT argued that given the current state of investment in and development of smart ticketing technology and products, the Ticketing Block Exemption should be re-evaluated sooner than the OFT’s proposed five years, perhaps in April 2012.57 The OFT found that, given its view of the state of current smart ticketing investment, the Ticketing Block Exemption did not need revision in 2010 to take account of smart technology, but that it should be open to the OFT to consider at any time whether changes to the Ticketing Block Exemption would be necessary as a result of smart ticketing developments.58

15.74 By contrast, FirstGroup argued that it would be premature to review the Ticketing Block Exemption. FirstGroup told us that smart technology was in its infancy with technology being rolled out according to different specifications, and that it was therefore difficult to predict which technological standard would prevail. FirstGroup told us that there was a significant danger in prescribing technologies in the Ticketing Block Exemption which might already be, or were likely to become, obsolete within a short period.59

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55 Response to Remedies Notice: PTEG, paragraph 8.16; SYTPE, paragraph 7g; Centro, p9. Response to provisional decision on remedies: TIGM, p14; PTEG, paragraph 7.22; SYTPE, paragraph 2.4, SPT, paragraph 2.5.
56 Response to Remedies Notice: PTEG, paragraph 8.17; TIGM, paragraph 1.2.11; SYTPE, paragraph 7g. SPT Response to Provisional Decision on Remedies, paragraph 2.5.
57 DfT response to OFT consultation on the Ticketing Block Exemption, July 2010.
59 Response to provisional decision on remedies, paragraph 3.33.
In our view, the considerable public and private sector investment in smart technology that has already been undertaken or is under way creates an important opportunity for increased competition (by reducing the barriers to entry and expansion that we have identified), and for delivering increased benefits to passengers through convenient and interoperable tickets. We find that the following three factors are the key to ensuring that this opportunity is taken.

First, the principles of an effective multi-operator ticketing scheme as set out in paragraphs 15.38 to 15.50 should also apply to ticketing products that are available on smart technology. For example, the level of any multi-operator cap on an e-purse should be set in accordance with the principles we define for multi-operator tickets in paragraphs 15.48 to 15.50.

Secondly, given the investments that have already been made and which we expect to be made in the near future, it is important that a clear competition law framework be established for the development of smart ticketing schemes. In this context, we noted the DfT’s submission that some smart ticketing products, such as e-purses, did not fit neatly within the categorization of the current Ticketing Block Exemption. We considered FirstGroup’s submission that it would be premature to revisit this aspect of the Ticketing Block Exemption (see paragraph 15.74). However, we did not agree that the provision of further guidance by the OFT on this issue—preferably by means of a review of the Ticketing Block Exemption or as a second best, as an interim solution, by means of a Short Form Opinion (see paragraphs 15.90 to 15.94)—would need to mandate any specific technology, or prevent the development of other technologies. We therefore concluded that the benefits of providing greater clarity about the types of e-purse schemes that are acceptable under competition law were likely to outweigh the potential risks described by FirstGroup.

Thirdly, the principle of interoperability is important in maximizing the benefits from smart ticketing, and this principle should be built into the development of smart ticketing schemes. Interoperability has two dimensions:

(a) Smartcards (or other smart media such as bank cards and mobile phones) should be interoperable across different operators in an area covered by a smart scheme so that a customer can board any bus using its smartcard. We understand that whilst smart-compatible ticket machines rolled out to date are ITSO compatible, in the future, new designs of bus ticket machines may also be able to accept standard cards and NFC-enabled mobile phones.

(b) The additional benefits in terms of competition, flexibility and convenience are likely to be maximized if customers are able to use a single e-purse within which single-operator and multi-operator caps are set. If there are different e-purses for single-operator and multi-operator capped products, then customers will have to commit in advance to which e-purse they use at the start of the day depending on their expectations of the usage they will make of the network, and there may be restrictions on acceptability by different operators which may undermine the value of interoperability.

In response to the provisional decision on remedies, the DfT submitted that it saw the following factors as important, if interoperability were to be effectively delivered in a smart environment, whilst enabling customers to use a single smartcard:

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60 An e-purse product from which money is deducted for each journey.
61 Near field communication, which allows for simplified transactions, data exchange, and wireless connections between two devices in close proximity to each other.
62 This would require additional business rules on ticket machines regarding the order in which different e-purses may be read.
(a) For prepaid products:

(i) operators would need to load multi-operator products on to their own branded cards; and

(ii) operators would potentially need to load their single-operator products on to others’ (including authority-led) cards.

(b) For ‘pay-as-you-go’ products:

(i) operators would need to accept others’ purses for payment as well as their own, for example a regional purse;

(ii) ideally, operators would participate in a regional purse rather than developing their own purse; and

(iii) ideally all purses (and other tickets) would use the same technology or else be easily aggregated with other technological options. The DfT noted that how the latter could be achieved was at present unclear.\(^63\)

15.80 The DfT noted that, currently, operators could choose whether to take any of the above actions, which meant that there was no guarantee that, with the roll-out of smart ticketing, more flexible and effective multi-ticketing would result. The DfT suggested that consideration be given to introducing additional requirements on operators—for example, requiring operators to make available their products on others’ smart media; expectations in relation to the relative pricing of single operator fares on different e-purses; and requirements to work actively with authorities in the development of regional e-purse schemes.\(^64\)

15.81 By contrast, FirstGroup submitted\(^65\) that it would be concerned if application of this principle of interoperability were to have the effect of mandating a specific technology for e-purses in terms of ITSO compatibility. We noted these concerns as well as FirstGroup’s submissions about the pace of technological change in this area (see paragraph 15.74) and the submissions that we received about the costs and practical challenges of implementing smart multi-operator ticketing schemes (see paragraph 15.66). In light of these submissions, we did not support PTE proposals to compel operators to participate in LTA-led smart schemes (see paragraph 15.72) as we concluded that decisions about issues such as the appropriate technology to be used would need to be made jointly by LTAs and operators, rather than imposed by one or other party.

15.82 Nonetheless, we took the view that, in reaching decisions about smart ticketing, the principle of interoperability would be an important factor to ensure that smart ticketing schemes delivered the maximum benefits for competition and for bus passengers. We found that the principles set out by the DfT in paragraph 15.79 provide a useful guide to the steps that were necessary to maximize interoperability and concluded, particularly in light of the public support that has been provided for smart ticketing equipment, that it was entirely reasonable to expect operators to work actively with authorities in the development of regional e-purse schemes. We also expect that national governments, as well as LTAs and bus operators, will have an important role to play in achieving the full benefits of smart ticketing, through disseminating best practice, keeping the applicable legislation under review and, where consistent with

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\(^63\) DfT response to provisional decision on remedies, paragraph 30.
\(^64\) DfT response to provisional decision on remedies, paragraphs 31–32.
\(^65\) FirstGroup response to provisional decision on remedies, paragraph 3.34.
their spending priorities, incentivizing participation in effective smart ticketing schemes, for example through BSOG (see Figure 15.7).

Implementation of remedy

15.83 In paragraphs 15.83 to 15.109 we present our decisions on ticketing remedies and how these will be implemented. In paragraphs 15.13 to 15.21 we found that the introduction of an effective multi-operator ticketing scheme is likely to make a significant contribution towards remedying the AEC that we have identified in relation to local bus services and tendering for supported services.

15.84 There are currently two ways in which a ticketing scheme could be introduced in an area:

(a) First, operators could voluntarily agree to set up a scheme, on the condition that such a scheme complied with the 1998 Act. For these purposes, there is a Ticketing Block Exemption, which allows for ticketing schemes that fall within the terms set out in the Block Exemption to be exempt from the Chapter I prohibition (see Appendix 12.1, Annex A, paragraphs 2 to 8).

(b) Second, LTAs can require operators in an area to set up a multi-operator ticketing scheme. These statutory schemes need to satisfy a competition test set out in the Transport Act 2000 for England and Wales and the Transport (Scotland) Act 2001 for Scotland (Appendix 12.1, Annex A, paragraphs 9 to 14).

15.85 In principle, the most timely and simplest solution to this aspect of the AEC would be for operators to work in partnership with LTAs to develop new schemes and reform existing schemes in accordance with the principles set out in this section, without the need for further changes to the legislative or competition policy framework. Such new or reformed schemes could be either voluntary or statutory in nature. We noted that there is little in the current legislative and competition policy framework to inhibit LTAs and operators from working together to develop and reform ticketing schemes in line with the principles set out in paragraphs 15.38 to 15.50.

15.86 In response to the provisional decision on remedies, FirstGroup noted that LTAs already had the power to promote multi-operator ticketing schemes and that the provisional decision on remedies for the first time provided LTAs with a ‘roadmap’ for designing an effective MTC scheme. It submitted that the efforts of LTAs would be better facilitated by the publication of best practice guidance (see paragraph 15.108) than by any change to the legislative or competition policy framework. Following publication of our provisional decision on remedies, Bath & North East Somerset Council and SPT have committed to working with local operators to reform their existing schemes in line with the principles set out in this section. We warmly welcome the initiative taken by these LTAs and also note the initial steps reported by FirstGroup towards introducing MTC schemes in Bristol and Swansea (see paragraph 15.27).

15.87 While we acknowledge these positive developments, we have found that existing avenues for setting up ticketing schemes did not adequately address the aspects of the AEC summarized in paragraphs 15.12 to 15.21. This is for a number of reasons set out in paragraphs 9.106 to 9.127 and Appendix 9.2. In short, not enough ticketing schemes have been introduced and the ticketing schemes that have been introduced...
are not sufficiently effective. We agree with FirstGroup that further dissemination of our analysis of the characteristics of an existing scheme is likely to facilitate the development and reform of ticketing schemes, and we have recommended the development of best practice guidance to assist LTAs (see paragraph 15.108). However, we are also mindful of the limited progress that has been made to date in developing effective schemes under existing legislation, as well as the incentives of operators with market power to resist the development of effective schemes where these would reduce barriers to entry and expansion. As a result, we do not expect that additional guidance to LTAs, by itself, would be sufficient. We concluded that a suitably comprehensive solution to this aspect of the AEC would also require changes to the legislative and competition policy framework.

15.88 We identified three ways to increase the number of effective ticketing schemes across the reference area:

(a) First, we decided that changes should be made to the Ticketing Block Exemption that would facilitate the introduction of more voluntary schemes (see paragraphs 15.89 to 15.92).

(b) Secondly, we decided that legislation should be created, or existing legislation should be amended, to give LTAs the power to set up multi-operator ticketing schemes in their area, with characteristics that would make them attractive to passengers and hence be effective in addressing the AEC (see paragraphs 15.93 to 15.97).

(c) Thirdly, we decided to recommend that LTAs should use their statutory powers and work with operators to introduce new MTC schemes and reform existing schemes in line with the principles set out in paragraphs 15.38 to 15.50. Pending the development of new legislation, we have made some interim recommendations about how LTAs could be supported in delivering change under the current legislative framework (see paragraphs 15.99 to 15.109).

- Changes to the Ticketing Block Exemption

15.89 The existing Ticketing Block Exemption provides a framework for operators to develop voluntary schemes in compliance with the 1998 Act. However, we have found that operators are discouraged from entering into voluntary arrangements to set up multi-operator ticketing schemes. This was in part as a result of general concerns about compliance with competition law,68 and because the existing block exemption provides insufficient legislative clarity on the revenue-sharing arrangements for non-MTC schemes that would still allow such schemes to fall within the terms of the block exemption (see paragraph 15.59) and on applicability to smart ticketing schemes (see paragraph 15.73).

15.90 If the following changes were made to the Ticketing Block Exemption and accompanying guidance, we would therefore expect there to be greater uptake of voluntary ticketing schemes:

(a) greater clarity about the types of revenue-sharing arrangements would be acceptable on MITs; and

(b) greater clarity about the types of e-purse scheme that are acceptable under competition law.

68 See, for example, ALBUM response hearing summary, paragraph 9.
15.91 We therefore decided to recommend to the OFT that it reviews the Ticketing Block Exemption in light of these issues at the earliest possible opportunity. We also decided to recommend to the Secretary of State for Business, Innovation and Skills that he make the changes to the Ticketing Block Exemption as recommended by the OFT.

15.92 In the provisional decision on remedies, we also sought views on whether, as an interim solution, we should recommend to the OFT that it issues a Short Form Opinion. SPT told us that it would welcome early guidance from the OFT in facilitating the introduction of e-purse schemes and revenue-sharing arrangements that were acceptable under competition law. In developing the new guidance, SPT would welcome consultation and expected that such guidance would provide for a range of possible e-purse and revenue-sharing arrangements. By contrast, FirstGroup told us that it saw no advantage in a Short Form Opinion, as it would not provide members of the specific scheme in question, or members of any other scheme, with legal certainty. We noted FirstGroup’s comments, but concluded that there are some potential benefits of a Short Form Opinion (on either or both of the issues highlighted in paragraph 15.90) in providing additional information to operators and LTAs about the types of arrangement that were likely to be acceptable to the OFT. On balance, therefore, we see some value in the OFT issuing a Short Form Opinion as a possible interim solution. However, we judge this to be second best and our clear preference is for a prompt review and revision of the Ticketing Block Exemption. We accordingly recommend such a review.

- **Increasing the powers of the LTA to set up effective ticketing schemes**

15.93 The amendments that we have decided to recommend to the Ticketing Block Exemption are likely to go some way towards mitigating the barriers to entry we have identified where these result from operators being discouraged from setting up schemes due to the terms of the block exemption. However, such remedial action will not address the limited incentives that operators have in setting up such schemes voluntarily, particularly where larger operators in an area offer their own single-operator network tickets.

15.94 In response to the Remedies Notice, most of the Large Operators emphasized that LTAs already had powers to set up statutory schemes mandating operator participation, and beyond these powers did not recognize the need for widespread compulsory participation. By contrast, some LTAs commented that they were not able to set prices (or other aspects of a scheme’s design) which limited the competitive impact from any statutory scheme, and some commented that powers should be extended to be able to define such terms.

15.95 We noted the existing powers of LTAs to establish statutory schemes, but agreed with LTAs that these powers were not sufficient to ensure that the resulting schemes would be effective. This could deter LTAs from setting up new schemes in the first place, as well as reducing the beneficial impact of those mandatory schemes that were established.

69 Response to provisional decision on remedies, paragraph 2.7.
70 Response to provisional decision on remedies, paragraph 3.38.
71 Response to Remedies Notice: Stagecoach, paragraphs 3.4, FirstGroup, response to 23e); Go-Ahead, paragraph 2.3.
72 Response to Remedies Notice: Stagecoach, paragraph 3.12; FirstGroup, response to 23e); Go-Ahead, paragraphs 2.8–2.10.
73 Response to Remedies Notice: Stagecoach, paragraph 3.12; FirstGroup, response to 23e); Go-Ahead, paragraphs 2.8–2.10.
74 Response to Remedies Notice: PTEG, paragraph 8.7; TIGM, p.3.
15.96 We have therefore decided to recommend to the Secretary of State for Transport (following consultation with the Welsh Government) and the Scottish Government that each gives LTAs powers to determine, in greater detail than at present, the form that statutory multi-operator ticketing schemes should take. We decided to recommend that LTAs are given the power to determine that the schemes have certain characteristics in relation to governance, access, bus-only schemes, zonal coverage, ticket types available, sales channels and marketing and pricing, as set out in paragraphs 15.38 to 15.50. We expect that these changes are likely to require additional legislation. The timescale over which such legislation would be introduced and whether such legislation would be primary or secondary in nature would be a matter for the relevant national governments to determine, though we noted that the DfT did not expect new primary legislation to be a short-term option.\footnote{DfT response to provisional decision on remedies, paragraph 17.}

15.97 To ensure that these powers also enable LTAs to reform the small number of existing statutory schemes, we also decided to recommend that any legislative change by the Secretary of State for Transport (following consultation with the Welsh Government) or by the Scottish Government should enable LTAs to make changes to existing LTAs-led schemes so that such schemes have the characteristics set out in paragraphs 15.38 to 15.50.

15.98 In paragraphs 15.65 to 15.82, we discussed the potential impact from the introduction of smart ticketing technology on the use of multi-operator schemes and the substantial investments by both the public and private sector in smart-enabled ticket machines. We decided that implementation of our recommendations should be technology neutral, allowing effective multi-operator ticketing schemes to operate both within and outside a smart ticketing context. We recommend that the Secretary of State for Transport and the Scottish and Welsh Governments take this into account when considering our recommendations.

- Recommendations to LTAs

15.99 In addition to the reforms to the legislative and competition policy framework set out in paragraphs 15.89 to 15.97, it will be necessary for action to be taken at a local level in order to remedy the AEC. LTAs will need to use their statutory powers and work with local operators to introduce new and effective ticketing schemes in areas where none currently exists and to reform existing schemes in line with the principles set out in paragraphs 15.38 to 15.50.

15.100 In relation to new schemes, we have found that the majority of Urban Areas do not have an Urban-Area-level MTC scheme and that, even among the 60 largest Urban Areas, only 35 per cent have an Urban-Area-level MTC scheme (see paragraph 15.29). Introducing new and effective MTC schemes into areas where none currently exists is likely to make a substantial contribution to remedying the AEC in those areas.

15.101 We have therefore decided to recommend that LTAs use their powers (both existing powers and, when these come into force, the new powers that we have recommended in paragraphs 15.93 to 15.97) to set up new statutory ticketing schemes, and/or work with operators to establish new voluntary schemes, which have the characteristics set out in paragraphs 15.38 to 15.50.

15.102 This recommendation applies particularly to the LTAs in the larger Urban Areas set out in Table 15.1, for which the competition benefits of introducing a new scheme are
likely to be most substantial, though we recognize that there is some variation between these Urban Areas and that there may also be significant benefits in introducing new schemes in smaller areas than this.\textsuperscript{76} In taking forward this recommendation, we recognize that it will ultimately be for the relevant LTA to determine whether the benefits of introducing an MTC scheme in any individual Urban Area are likely to outweigh the costs (see paragraph 15.35 and Appendix 15.8).

15.103 We have found that existing voluntary schemes and the small number of LTA-led schemes are insufficiently effective, as currently constituted, to address adequately the aspects of the AEC summarized in paragraphs 15.12 to 15.21. This is because each scheme’s characteristics are to some extent unattractive to consumers, and hence the take-up of these schemes is generally low (see paragraphs 15.37 and 15.38, and Appendix 9.2). To address the AEC effectively, it will therefore be necessary to reform existing schemes, as well as to establish new schemes.\textsuperscript{77}

15.104 We have therefore decided to recommend that LTAs use their statutory powers, as necessary, and work together with operators to reform existing schemes, in line with the principles set out in paragraphs 15.38 to 15.50.

15.105 In our judgement, the n-Bus scheme in the West Midlands is a particular priority for early reform. This is because of the extent of barriers to entry associated with network effects in the West Midlands area (see paragraph 9.94), the low take-up of the existing n-Bus scheme compared with other PTE schemes (see paragraph 15.36), the absence of tickets that cover smaller zones than the entire West Midlands area (see Appendix 15.2, Annex A)\textsuperscript{78} and the shortcomings of the governance of the scheme, in particular the veto held by National Express (see paragraph 9.121).

15.106 However, we have found that all existing schemes have one or more characteristics that are likely to reduce their attractiveness to passengers (see paragraph 15.37) and therefore consider that the case for prompt reform of existing schemes goes much wider than just the West Midlands. We expect that our analysis of existing schemes in Appendix 9.2, our detailed consideration of the characteristics of an effective scheme in Appendix 15.2, along with the best practice guidance that we have recommended in paragraph 15.108, will provide a starting point for the reform of existing schemes.

15.107 While our preferred solution involves a change to legislation to empower LTAs to ensure that MTC schemes are effective, we are conscious of the timescale for introducing new legislation and the desirability of achieving change within a short period of time. We also recognize that there is little in the current legislative and competition policy framework that would prevent LTAs from working together with operators to introduce new and effective MTC schemes, or to reform existing schemes, in line with the principles set out in paragraphs 15.38 to 15.50.

15.108 To support LTAs in promptly delivering the changes that we have found to be necessary, we have decided to recommend as an interim solution that the DfT (following consultation with the Welsh Government) and the Scottish Government develop guidance setting out the characteristics of an effective multi-operator ticketing scheme. We also recommend that LTAs and operators have regard to this guidance and work together to develop new MTC schemes and amend existing

\textsuperscript{76} For example, a multi-operator scheme exists in Bath, an Urban Area with a population of 90,000, which involved very low costs of set-up and ongoing administration.

\textsuperscript{77} We therefore disagreed with Arriva’s suggestion (response to provisional decision on remedies, paragraph 2.8) that we should focus solely on encouraging MTC schemes in areas where none exist now.

\textsuperscript{78} This issue is also relevant to the System One scheme in Greater Manchester and the Metrocard scheme in West Yorkshire.
schemes in advance of new legislation being brought into force. During this transitional period, we recommend that the Secretary of State for Transport and the Scottish and Welsh Governments monitor progress of LTAs and operators to achieve these outcomes.

15.109 To provide an additional incentive on operators to participate actively and constructively in the development of new schemes and the reform of existing schemes, we have also decided to recommend to the DfT that, as part of its current review of BSOG in England, it considers ways of incentivizing development and participation in effective multi-operator ticketing schemes (see Figure 15.7 in paragraph 15.403). This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

Operator behaviour

Summary of remedy

15.110 Figure 15.2 summarizes our remedy in relation to operator behaviour.
We have decided, given that operators have an incentive to compete in ways that can lead to a rival’s exit rather than through ongoing competition on the merits of their respective offerings, to recommend that:

- The Secretary of State for Transport (following consultation with the Welsh Government) makes changes to the notice period and requirements relating to the registration and operation of a local bus service in England (excluding London) and Wales as follows:
  
  (a) a 14-day pre-notification period to LTAs by operators prior to any registration application to enable LTAs to review and comment on the proposals;
  
  (b) a minimum standard notice period of 90 days following acceptance of a change to an existing service registration by the Traffic Commissioner before such change can be made; and
  
  (c) a restriction on making changes to any registration application during any notice period except by making a short-notice application and the alignment of the reasons for any short-notice application to those used in Scotland.

- The Scottish Government and the Secretary of State for Transport (following consultation with the Welsh Government) make changes to the relevant national legislation and regulations relating to the operation of local bus services to:
  
  (a) require operators to detail and then to operate within registered hourly frequency bands any services that are registered as frequent services;
  
  (b) require Traffic Commissioners to introduce and enforce a local bus operator Code of Conduct; and provide them with the ability to attach the conditions of such a Code of Conduct to operator licences and/or to local bus service registrations; and
  
  (c) enable Traffic Commissioners to restrict local bus service registration applications (for new or changed services) for up to 90 days (in any two-year period) in an area in which a municipal bus company operates when such business is being sold and on request from the relevant local authority owner.

- Traffic Commissioners work in consultation with the local bus industry to agree, introduce and enforce compliance with an industry Code of Conduct which will preclude ‘cheap exclusion’ and emphasize the need to comply with existing competition laws.

- As part of its current review of BSOG in England, the DfT considers ways of incentivizing compliance with our Code of Conduct (see Figure 15.7 in paragraph 15.423). This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

*How this remedy addresses the AEC*

15.111 We found that bus operators have an incentive to compete in ways which are likely to create overcapacity and to compete in a way that is aimed at promoting a rival's exit.
We found that these incentives can result in a market outcome in which head-to-head competition, when it occurs, is less likely to be sustained (see paragraph 11.46).79 We found that the nature of competition that arises following entry, including the reactions of incumbent operators, can increase entry costs, risks and uncertainty and the anticipation of this risk acts as a barrier to entry or expansion. We also found that ‘cheap exclusion’ can also form a barrier to entry.80

15.112 The remedies in this section seek to address the barriers to entry and expansion, associated with the expectations of post-entry competition and cheap exclusion.81 In so doing, we expect the remedies to increase the likelihood of head-to-head competition being sustained. Our remedial measures seek to achieve this in the following ways:

(a) First, by constraining the ability of operators to make rapid and frequent changes to service frequencies. By increasing notice periods for changes to registered local bus services, the number of changes an operator can make to its services in any period is reduced. The application of longer notice periods also slows any potential response by an incumbent operator to a service change by an entrant or another competitor. These effects and the requirement to pre-notify LTAs of service changes are aimed at reducing the incentive and ability of an operator to take a short-term, tactical approach to making decisions about service frequency. As a result, an operator seeking to enter or expand services in competition with an incumbent operator would expect less opportunity for ‘tit-for-tat’ reactions and hence lower barriers to entry or expansion. We expect this to increase both the likelihood of entry occurring and the likelihood of competition being sustained following entry.

(b) Second, the Code of Conduct discourages operators from engaging in practices of cheap exclusion and from other types of anticompetitive practice in breach of the Competition Act in order to damage or discourage a competitor. This is the expected result of being clear about the type of such behaviour that is prohibited and by providing an appropriate deterrent or punishment for breaches of the Code. As a result, the barriers to entry and expansion are reduced.

(c) Third, the protection for municipals, through local restrictions on relevant service changes for a maximum period, aims to prevent damaging behaviour by other operators during a sales process. Such behaviour can arise from operators taking advantage of the vulnerability of municipals during this period and of the ability to target a rival.82 The remedy is expected to remove the potential for the viability of a municipal to be undermined and thus its sale to a rival either prevented or the business and its competitive position weakened before the sale. In these ways, we expect this measure to prevent competition from being distorted in future, should any of the remaining municipal operators be put up for sale.

79 We refer specifically to the finding that operators in head-to-head competition on a route may face incentives to compete in ways which increase service frequency and make the service loss-making, until one or other exits. Without these incentives (which derive, in part, from our feature of customer conduct), we would expect sustained head-to-head competition to be possible where operators are engaged in active rivalry, such as on fares and service levels, where competition continues in the long term on the merits of their offers, as one would normally expect of a competitive market. Without the features we have identified ongoing head-to-head competition could be sustained with no agreements or understanding between operators on a route or over a wider area, or external control of the market required.

80 See paragraphs 8.275–8.277 for a description of the practices that constitute cheap exclusion.

81 See paragraph 14.7.

82 See paragraphs 8.59 & 8.60.
Design issues

15.113 In paragraphs 15.114 to 15.213 we explain the way in which the remedies have been designed and the factors we have taken into consideration. We look at:

(a) the general considerations that shaped our approach to remedies to address unilateral operator behaviour (see paragraphs 15.114 to 15.127);

(b) changes to the registration process (see paragraphs 15.128 to 15.182);

(c) the Code of Conduct (see paragraphs 15.183 to 15.201);

(d) the protection for municipal businesses during a sales process (see paragraphs 15.202 to 15.211); and

(e) the geographic scope of the remedy (see paragraphs 15.212 and 15.213).

- General considerations that shaped our approach

15.114 In order to guide our approach, we started by looking at some general considerations. We considered a variety of potential approaches to the design of this remedy option and asked a number of detailed questions in the Remedies Notice about different aspects of the design and effectiveness of the remedy.

15.115 We considered whether it would be possible for an existing body such as Traffic Commissioners or LTAs, or a new regulatory body, to determine what constituted inappropriate operator behaviour and, as a result, make decisions about restricting such behaviour on a case-by-case basis. Alternatively we considered whether it was possible for the CC to specify rules which would draw a clear line between appropriate and inappropriate behaviour. We considered whether such rules should be highly specified and tailored or simple and universal and who should monitor and enforce them.

- An appropriate body to make judgements

15.116 We considered first whether the Traffic Commissioners, LTAs or a new regulator could make judgements on whether any specific action by an operator (eg a service registration or a price change) was likely to distort competition.

15.117 There were common views about Traffic Commissioners. The current resources available to assist Traffic Commissioners are under review and many parties thought that these were insufficient to cover an extension in the role.\(^{83}\) There is a related move away from monitoring of local bus services by Vehicle and Operator Services Agency (VOSA) compliance officers to a partnership approach with the industry and Traffic Commissioners have expressed concerns to us about how well they will be supported as a result in future.\(^ {84}\) Many parties told us that Traffic Commissioners had already said that they did not necessarily have the current skill set to investigate matters of anticompetitive behaviour by operators.\(^ {85}\) Traffic Commissioners them-

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\(^{83}\) For example, NCT response to Remedies Notice, p7; Go-Ahead response to Remedies Notice, p10; PTEG response to Remedies Notice, p16.

\(^{84}\) Deputy Senior Traffic Commissioner response hearing summary, paragraph 2; Scottish Traffic Commissioner response hearing summary, paragraphs 2 & 3.

\(^{85}\) For example, Arriva response to Remedies Notice, p27; FirstGroup response to Remedies Notice, p19, Rotala response to Remedies Notice, p4; and PTEG response to Remedies Notice, p16.
selves and the DfT thought that an extension in the role could be possible, although difficult.86

15.118 We decided that any extension to the role of the Traffic Commissioners should be incremental, build on their existing strengths of independence and industry credibility and be relatively light in terms of additional demands on VOSA. However, for the reasons set out in paragraph 15.117, we did not find that it would be practicable for Traffic Commissioners to make judgements on a case-by-case basis as to whether a registration application or price change was likely to be anticompetitive.

15.119 Next, we considered what role LTAs could play. Here a wider range of views were expressed both by parties, ranging from LTAs acting as formal regulators to LTAs having a monitoring role of some sort.87

15.120 We recognized the specific strengths of LTAs that are relevant to this remedy. They have local knowledge and are responsible for local transport plans. All LTAs are involved to some extent in the local bus market. Against this, LTAs had a range of views as to their willingness or ability to extend their role.88 There were also some concerns expressed that LTAs could be subject to political influence and were therefore not fully independent.89 Based on this evidence, we were concerned that LTAs would not be seen as being sufficiently independent to make decisions about what constituted inappropriate behaviour by operators. However, we took the view that it would be important to involve the LTAs in some other way, as their local knowledge and contacts with operators would enhance the effectiveness of this remedy.

15.121 Whilst recognizing that Traffic Commissioners and LTAs play an important role in the local bus market, we concluded that it was not practicable for their role to be extended to include assessing the competitive implications of price or frequency changes on a case-by-case basis. Nor did we consider that any other regulatory option, including the creation of a new bus regulator, would be likely to be effective as such a regulator would not have local knowledge, nor was it likely that there would be resources to fund such a body.90

- Use of tailored rules to identify inappropriate behaviour

15.122 We next considered whether tailored rules could be established to determine the circumstances in which an action by an incumbent operator in response to entry was likely to be inappropriate.

15.123 Some parties told us that it would not be possible to define the sort of operator behaviour that was inappropriate.91 Several operators also emphasized the practical difficulties in specifying the remedy.92 We were told that:

(a) A decision would need to be taken on what constituted an incumbent and what constituted an entrant. For example, there are relatively few services that overlap completely so clear criteria would need to be set, as to what extent of overlap

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86 Deputy Traffic Commissioner response hearing summary, paragraph 8.
87 For example, PTEG response to Remedies Notice, pp15–17; ALBUM response hearing summary, paragraph 18; and DfT response hearing summary, paragraph 30.
88 For example, Dorset County Council response hearing summary, paragraph 29; Centro response hearing summary, paragraph 22; and PTEG response to Remedies Notice, p16.
89 For example, National Express response hearing summary, paragraph 29; Arriva response hearing summary, paragraph 19.
90 We took account here of the views of PTEG in its response to the Remedies Notice, p16.
91 For example, Arriva response to Remedies Notice, pp26, 28 & 29; Lothian response to Remedies Notice, p17; PTEG response to Remedies Notice, p17.
92 For example, National Express response to Remedies Notice, pp17&18; Stagecoach response to Remedies Notice, pp23 & 24; and FirstGroup response hearing summary, paragraph 25.
would constitute entry on to a particular route and what would constitute an incumbent reaction on that route.

(b) Such a rule-based approach could bring potential distortions, especially given that this would provide favourable treatment to the entrant and might in contrast prevent an incumbent reacting to customer demand.

15.124 We recognized the significant difficulty in tailoring rules designed to afford a degree of protection to an ‘entrant’ from an ‘incumbent operator’. We agreed with the points made about the difficulty in defining the relevant circumstances in which to provide such protection. Being clear on these areas would be fundamental to the successful operation of a tailored rules-based approach.

15.125 We therefore concluded that there was a significant risk of error in the design and execution of tailored rules, which could lead to distortions in the competitive process. We recognized that the nature of such distortions depended on the specification of the remedy but we judged that the scope for such distortions was likely to increase with the complexity of the remedy.

o Simple universal rules

15.126 As a result of our assessment in paragraphs 15.116 to 15.125, we concluded that only simple and universally applied rules could be effective and practicable in addressing this aspect of the AEC. For the reasons set out in paragraphs 15.116 to 15.121, we did not consider that it would be practicable for LTAs, Traffic Commissioners or a new regulator to assess, on a case-by-case basis, whether individual pricing or service changes would distort competition. Likewise, for the reasons set out in paragraphs 15.122 to 15.125, we considered that seeking to design tailored rules to identify and deal with specific instances of anticompetitive behaviour risked causing significant distortions or errors. Rather we concluded that rules aimed at improving the general stability of services and increasing the visibility of operator behaviour were more likely be more effective.

15.127 We took the view that if it were possible to deliver remedies affecting the frequency of services through the existing registration process with the Traffic Commissioners, this would minimize the costs involved, would make implementation easier and would therefore also be a practicable approach.

• Changes to registration process

15.128 Having considered the views on a range of remedy options, we have identified three areas for change to the registration process:

(a) introducing a 14-day pre-notification period to LTAs (paragraphs 15.129 to 15.139);

(b) extending the period for a change to an existing registration to 90 days (paragraphs 15.140 to 15.170); and

(c) changes to frequent service registration requirements (paragraphs 15.171 to 15.182).

In making this assessment, we agreed with the view of the DfT that if rules were clear and simple and minimized the degree of judgement, a rule-based approach could be made effective. (Response hearing summary, paragraph 31.)
15.129 We explored this option in response hearings and recognized that this is already the practice in Scotland. We heard a range of views about the extent of the usefulness of this period in Scotland.\textsuperscript{94} Some parties outside Scotland told us that more widespread dialogue between operators and LTAs about proposed service changes already existed or that the sharing of such information would seem to be beneficial.\textsuperscript{95} However, a concern was expressed that if LTAs had an objection to a service on the grounds of potential distortions to competition, Traffic Commissioners would not be able to act on this without additional powers.\textsuperscript{96}

15.130 Following publication of the provisional decision on remedies, a number of parties welcomed the proposal. The DfT supported the proposal, as it said that in the past LTAs had told it they did not have enough time to procure replacement services where necessary, or to update information.\textsuperscript{97} PTEG expressed similar points,\textsuperscript{98} and Centro described the benefits it already got from voluntary pre-notification of changes by operators and that making this a requirement might benefit other areas.\textsuperscript{99} In contrast, Go-Ahead thought that the 14-day period was unnecessary as it did not add anything more to address the AEC over and above the proposed 90-day notice period. It did not think that its use in Scotland was to address competition issues.\textsuperscript{100} Stagecoach emphasized that it did not address the AEC as LTAs had no powers to change a registration.

15.131 We received feedback on how LTAs should handle the information during the 14-day period. FirstGroup told us that it thought that the information should be kept confidential as otherwise if this was shared with competitors it might fall foul of competition law.\textsuperscript{101} Rotala was also concerned about the disclosure of confidential information to other operators and thought that LTAs should obtain specific permission to do this.\textsuperscript{102} Cheshire West and Chester Council thought that there needed to be guidelines and criteria developed by LTAs and Traffic Commissioners to guide the process and these would cover confidentiality and allow neighbouring LTAs to discuss cross-boundary issues.\textsuperscript{103}

15.132 We considered the possibility that some operators would not be able to give an extra 14 days’ notice without incurring costs as a result of being required to keep running an unprofitable service. We did not see any evidence that would suggest that such costs would be significant.\textsuperscript{104} Nor did we see any evidence to suggest that the operation of the notice period in Scotland has had any significant costs: which suggested to us that operators had adapted and taken account of the need to give an extra period of notice to the LTA when changing or cancelling a service.

\textsuperscript{94} For example, Scottish Government response hearing summary, paragraph 17; Scottish Traffic Commissioner response hearing summary, paragraph 10; SPT; and Lothian Buses response hearing summary, paragraph 15.

\textsuperscript{95} For example, National Express response hearing summary, paragraph 29; Stagecoach response to Remedies Notice, p18; and Deputy Senior Traffic Commissioner response hearing summary, paragraph 6.

\textsuperscript{96} DfT response to provisional decision on remedies, paragraph 38.

\textsuperscript{97} PTEG response to provisional decision on remedies, paragraph 10.1.

\textsuperscript{98} Centro response to provisional decision on remedies, paragraphs 2.1 & 2.2.

\textsuperscript{99} Deputy Senior Traffic Commissioner response hearing summary, paragraph 6.

\textsuperscript{100} Go-Ahead response to provisional decision on remedies, paragraph 3.4.

\textsuperscript{101} FirstGroup response to provisional decision on remedies, paragraph 4.6.

\textsuperscript{102} Rotala response to provisional decision on remedies, paragraph 20.

\textsuperscript{103} Cheshire West and Chester Council response to provisional decision on remedies, p1.

\textsuperscript{104} At a late stage in our investigation, Stagecoach provided one example of a situation in which it had recently been refused a short notice application to terminate a service, and submitted that, had a 14-day pre-notification period been in place, Stagecoach would have been required to run empty buses for an additional two weeks while it consulted with the LTA. We noted this one example, though we also noted that, in some situations, a dialogue between operators and LTAs during this 14-day period may increase the likelihood of a short-notice application being accepted.
15.133 We concluded that there would be benefits of providing LTAs with information about forthcoming registration applications, as part of our remedy package. In our view, LTAs have useful local knowledge and could apply a wider perspective when discussing proposed service changes with operators. We identified that LTAs pose some constraint on operators given the funding that they control and the established partnership approach that is encouraged.\textsuperscript{105} As a result, we expect that the extra visibility to LTAs resulting from this measure could discourage anticompetitive reactions by an incumbent operator to a new entrant.

15.134 We agreed that a set of guidelines for LTAs would be helpful and that these should include guidance on the treatment of confidential information. These guidelines can be best developed by LTAs and Traffic Commissioners as part of the wider changes to the registration process, and we would expect such guidelines to be subject to consultation.

15.135 We noted that this measure would encourage information sharing and dialogue between LTAs and operators and that this is consistent with the principle of effective partnership working (see paragraphs 15.373 to 15.422). This measure supports other changes to the registration process (see paragraphs 15.140 to 15.181) and will help LTAs in assessing the need to support services that were to be withdrawn and might need to be tendered in future (see paragraphs 15.291 to 15.339).

15.136 We also took the view that LTAs were well placed to assist in bringing concerns relating to breaches of the changes to registration periods (see paragraphs 15.140 to 15.182), the Code of Conduct (see paragraphs 15.183 to 15.200) and the 1998 Act (see paragraphs 15.340 to 15.372) to the attention of the Traffic Commissioner and/or the OFT, and that in doing this LTAs could perform a useful monitoring role.

15.137 We considered whether, in addition to any obligation on operators to notify LTAs of forthcoming service changes, there should be a statutory duty for LTAs to review registration applications. However, we did not think that this was practicable as it would be difficult to generalize about the precise actions that they should undertake or the realistic grounds on which they might object to an application.

15.138 Finally, we considered the appropriate length of the pre-notification period. As the period is currently 14 days in Scotland and there is an established process in operation, we could see no reason to adopt a different approach in England and Wales.

15.139 We therefore decided to recommend that LTAs be given notification of any new local bus service registrations or changes to existing services (including cancellations) 14 days prior to submission of a registration application to the Traffic Commissioner.

- Extend period for a change to an existing registration to 90 days

15.140 Currently, operators must give 56 days’ notice to the Traffic Commissioner of most local bus service registration changes in the reference area. In Scotland, an operator must also operate any new or changed service for at least 90 days. In our provisional decision on remedies, we consulted on an increase in the standard notice period to 90 days in England and Wales for changes to local bus service registrations.\textsuperscript{106} We did not propose changes to the registration period for new registrations or for service

\textsuperscript{105} See Appendix 11.1, paragraphs 26–28.

\textsuperscript{106} The potential for short-notice registration applications will remain although, as explained in paragraph 15.161 the reasons permissible for a short-notice registration should be aligned to those used in Scotland.
deregistrations (see paragraph 15.150). Nor did we propose changes in relation to Scotland (see paragraphs 15.152 to 15.154). We received a significant amount of feedback on this proposal and our consideration of the issues it raises is structured as follows:

(a) First, we summarize the comments made about this proposal (see paragraphs 15.141 to 15.145).

(b) Secondly, we set out our assessment of the issues raised in these comments (see paragraphs 15.146 to 15.151).

(c) Thirdly, we compared this proposal with the current arrangements for service registration in Scotland (see paragraphs 15.152 to 15.154).

(d) Fourthly, we discuss any implications for the process for short-notice applications (see paragraphs 15.155 to 15.162).

(e) Fifthly, we discuss potential circumvention risks and how these can be managed (see paragraphs 15.163 to 15.170).

- Parties’ views on this proposal

15.141 We received a range of views about this proposal, following publication of the provisional decision on remedies.

15.142 The DfT told us that there was a trade-off between forcing operators to give longer notice periods, and the benefit this achieves through reducing the potential for predatory behaviour, and giving passengers more time to adjust their travel plans. A cost of the remedy was that an unprofitable route might have to be run for a longer period of time before alterations could be made and it thought that these costs, when totalled over a number of routes, could be substantial (see Appendix 15.8). But provided that the benefits of the remedy offset the costs, it told us that this remedy could be implemented through secondary legislation.107

15.143 The Large Operators were generally opposed to this measure:

(a) Arriva told us that the 90-day notice period appears to have been picked from the practice in Scotland without any review of whether it is the appropriate period. It said that the issue of whether competition would be enabled by the 90 days’ notice period compared to the existing 56-day period needed to be addressed.108

(b) FirstGroup told us that there were good policy reasons for the current 56 days’ notice period and that there was always the need to strike a balance between the ability of operators to respond to changing circumstances and the need to give warning to LTAs about service changes. Were the 90 days to be implemented, it said that the notice period should run from the day on which the change in the registration application was received by the Traffic Commissioner and not from the date it was ‘accepted’. It considered that the reason for the distinction in the

107 DfT response to provisional decision on remedies, paragraphs 43–46.
108 Arriva response to provisional decision on remedies, paragraph 3.5.
current regime was to allow LTAs time to consider the application and comment on the need for a traffic regulation condition.109

(c) National Express told us that there was no distinction drawn in the remedy between increases in frequency which give rise to customer benefits and those which are inappropriate. It said that the 'one size fits all' approach was disproportionate. It also said that there was a risk that this remedy might discriminate in favour of new entrants, as the extended notice period did not apply to new registrations. There would be no guarantee that these new entrants would be any more efficient than the incumbent operator, but they might be able to gain an unfair commercial advantage by running services shortly ahead of the incumbent operator. National Express also argued that new entrants might be subject to higher barriers to entry and expansion as once they had entered they would only be able to alter services after the extended period of notice.110

(d) Go-Ahead accepted that the remedy was designed to make it more difficult for incumbents to react to new entrants. But it told us that this rule would mean that operators would be left with little flexibility in optimizing demand and responding to changing circumstances and this would have the likely consequence of customer disbenefits. It provided a number of examples of what it said were such circumstances, including accommodating new developments where the exact opening date was not certain and responding to changes to educational institutions’ opening hours. It said that the increased notice period would create more uncertainty and act as a deterrent to altering services.111

(e) Stagecoach told us that the vast majority of changes to local bus registrations were made for commercial reasons in responding to passenger demand and external factors (for example, fuel price increases) or to satisfy the requests of customers and LTAs, not in response to the behaviour of competitors. It provided some examples of the additional costs it would have incurred if it had had to wait longer to make alterations to services. More detail on these examples is set out in Appendix 15.8, paragraphs 68 to 73.112 Stagecoach also expressed a particular concern about potential issues with responding to the impact of changes to concessionary fare reimbursement arrangements and providing the required notice.113 Stagecoach did not consider that there was any rationale for adopting a more onerous remedy than that which applied in Scotland.114

15.144 Similar comments were made by most of the small and mid-sized operators that responded to the provisional decision on remedies. EYMS said that it could understand the rationale for the proposal but that it would have a major disadvantage in other situations and would perversely also make it more difficult for a new competitor to make sensible alterations to newly registered services.115 Rotala thought that the approach was disproportionate and that it should be possible to develop a targeted approach based on requiring a remaining operator, following a period of competition,

109 FirstGroup response to provisional decision on remedies, paragraphs 4.1 & 4.2. We were not convinced that this change was required as there may be other checks necessary and wider implications. But this is a point that could be taken forward by the DfT in the detailed design of the remedy.
110 National Express response to provisional decision on remedies, paragraph 4.6a–d.
111 Go-Ahead response to provisional decision on remedies, paragraphs 3.6–3.8.
112 Stagecoach response to provisional decision on remedies, paragraph 4.7 & Annex 2.
113 For example, if reimbursement rates were reduced, this might affect the viability of services. Stagecoach told us that, although TCAs were required to give four months’ notice of proposed changes to travel concession schemes, in practice either by the time these are finalized or in cases where these are appealed, resolution could happen close to the date when the changes were due to be implemented. This resulted in a conflict even with the existing 56 days’ notice periods. Stagecoach response to provisional decision on remedies, paragraphs 4.11–4.13.
114 Stagecoach response to provisional decision on remedies, paragraph 4.19.
115 EYMS response to provisional decision on remedies, paragraph 21.
to maintain and operate capacity for an extended period.\textsuperscript{116} NCT noted that the period of 90 days was not divisible by seven into weeks and argued that the remedy was disproportionate to any benefit that might be generated.\textsuperscript{117} In contrast, the response from three (small) West Midlands operators welcomed the proposals.\textsuperscript{118}

15.145 The views of LTAs were mixed. The feedback from Centro was similar to most of the operators. It believed that the current 56 days` notice period was adequate and thought that the proposals would complicate the process and might make operators more conservative.\textsuperscript{119} Some PTEs thought that the extended notice periods should apply to newly registered services and deregistrations to help offset any circumventions risks (see paragraphs 15.163 to 15.170 below).\textsuperscript{120} ATCO told us that the proposals did not go far enough. It thought that limiting the number of timetable changes to a set number of dates, to be established by LTAs, would be an important measure to provide the travelling public with confidence about the services that were operating and that a statutory national framework could be beneficial.\textsuperscript{121}

- Our assessment of this proposal

15.146 We gave careful consideration to the impact of the proposed extension to the notice period and paid particular attention to parties` concerns about possible adverse effects of the measure. In doing so, we evaluated the impact of the 90-day period of notice and the 14-day pre-notification period to LTAs (see paragraphs 15.129 to 15.138) and found that this limited the number of general service changes on a route to about three to four occasions per year.\textsuperscript{122}

15.147 We noted, first, that the barrier to entry and expansion associated with the expected nature of post-entry competition was a significant barrier and that the associated tendency for head-to-head competition not to be sustained was an important aspect of our AEC finding. As set out in paragraph 15.112(a), this measure is designed to reduce this barrier to entry and expansion—and increase the likelihood that head-to-head competition will be sustained—by increasing the time that it takes for an incumbent to respond to a new entrant or expanding operator. When and if such a response takes place, it will need to be maintained for a longer period, increasing the cost to the incumbent of an aggressive, short-term response. These factors are likely to reduce the ability and incentive to engage in ‘tit-for-tat’ competition (ie short-term changes to react to competitor behaviour). We expect that this will also increase the strength of potential competition and incentivize incumbent operators to maintain a good service. It would encourage both entrants and incumbents to make sensible decisions about new services or changes to services. We concluded that the benefits of introducing this measure were likely to be important, especially in conjunction with other complementary market-opening measures, such as effective multi-operator ticketing schemes (see Figure 15.1) and the provision of fair access to bus stations (see Figure 15.3). The combination of these measures is likely to reduce barriers to

\textsuperscript{116} Rotala response to provisional decision on remedies, paragraph 21.
\textsuperscript{117} NCT response to provisional decision on remedies, paragraphs 3.1–3.2
\textsuperscript{118} Geoffrey Howle response to provisional decision on remedies.
\textsuperscript{119} Centro response to provisional decision on remedies, paragraphs 2.4–2.7.
\textsuperscript{120} For example, see PTEG response to provisional decision on remedies, paragraph 10.2; Nexus response to provisional decision on remedies, paragraph 3.1.
\textsuperscript{121} ATCO response to provisional decision on remedies, paragraph 5.
\textsuperscript{122} The exact number of service changes that can be made during a year depends on the assumptions made, but one new registration and up to three planned changes would be feasible in a year in this design. In response to the provisional decision on remedies, Stagecoach told us that four concurrent occurrences of 104 days (14 and 90 days) could not be accommodated in a year (Stagecoach response to provisional decision on remedies, paragraph 4.14). Whilst, as we set out (in paragraph 15.170) below, it is not possible to make changes to a registration during the notice period with the Traffic Commissioner, it would be possible to overlap a new 14-day consultation period with a 90-day notice period relating to a prior service change.
entry and expansion and to increase the likelihood that new entry results in competition that is sustained over the longer term.

15.148 Secondly, in considering the scope for the remedy to have adverse effects, we have placed weight on the desire of many parties to encourage more stability of services for the benefit of passengers. There are many existing local voluntary agreements limiting the number of changes to services that can take place in a given period. We also noted that, in Scotland, obligations which have a similar effect on the ability of operators to make a large number of service changes in a given period appear to have been accommodated without giving rise to significant adverse effects. We have also received evidence that operators take time to plan service changes, and this period of planning is sometimes longer than the proposed notice periods. We recognize that one-off changes (such as, for example, a new hospital) would be an exception to this and that where the exact date of opening (for example) was not known, the short-notice application process will continue to be useful (see paragraphs 15.155 to 15.162). In light of these considerations, we concluded that the extent of any adverse effects of an increase in the notice period from 56 to 90 days of this measure was likely to be small and was capable of being further mitigated by legitimate use of the short-notice applications process. In reaching this view, we took account of the evidence regarding the potential costs of the remedies, which are set out in Appendix 15.8.

15.149 Thirdly, in light of the comments that we received about this measure, we considered the appropriate notice period for changes to service registrations. We agreed with FirstGroup that there was a balance to be struck in determining this parameter. We noted that there was a need to exercise judgement in so doing, and that this judgement was likely to be qualitative in nature. We considered that, in light of the AEC that we had identified, a significant increase from the current 56-day notice period was required if the remedy was to be effective in its aim of reducing barriers to entry and expansion and increasing the opportunities for sustained competition. On the other hand, there is the need to balance any possible reduction in flexibility. While we were comfortable that, with a 90-day notice period (considered together with a 14-day pre-notification period for LTAs), any such adverse effects were likely to be modest, the risks of material adverse effects (including undue demands being placed on the short-notice process) would increase with longer notice periods. We concluded that a 90-day notice period strikes the right balance.

15.150 Fourthly, we considered whether the 90-day period should apply to all service registrations or just to changes to registration. We have decided that these extended notice periods should apply to changes to existing services but should not apply to registrations for new services or for cancellations of existing services. This is because applying extended notice periods to new services or cancellations might have the undesirable effect of increasing the barriers to entry and expansion and increasing the opportunities for sustained competition. It could increase the time for an entrant to launch a new service and give an incumbent a longer period in which to react before the new service started operating. In addition, should a service be operating at a loss, the period of time over which the loss could be incurred before the service could be cancelled would be further increased compared with the current 56-day notice period. As a result, we decided to continue to allow the cancellation of a service after 56 days, although recognizing that this would require 14 days’ prior notice to the LTA. We noted that this created an asymmetry

123 For example, Passenger Focus response hearing summary, paragraph 16; Lothian Buses response hearing summary, paragraph 16; Arriva; ATCO response hearing summary, paragraph 27.
124 The DIT told us that it estimated that half of the market was already subject to voluntary agreements on timetable changes of some sort or another.
125 For example, FirstGroup; National Express response hearing summary, paragraph 29.
between the position of an entrant and an incumbent. However, given that we have found competition to be prevented, restricted or distorted by barriers to entry and expansion, we did not find that this limited asymmetry itself created a material distortion.

15.151 We concluded that, in light of the above considerations, this measure would substantially reduce barriers to entry and expansion and increase the likelihood of competition being sustained, without creating disproportionate adverse effects. As a consequence, we decided to include this measure in our remedy package.

- **Comparison with notice requirements in Scotland**

15.152 Our preferred remedy design differs from the current registration requirements in operation in Scotland. For example, in Scotland, if an incumbent had been operating a service for 90 days, that operator only needed to give 56 days’ notice of a change to its service. In our remedy, an operator would always have to give 90 days’ notice of a change irrespective of how long the service had been operated. Also, as set out in paragraph 15.149, we decided to allow an exit from a service with 56 days’ notice (i.e., the minimum operational period for a service would be 56 days). This is less than in Scotland and would reduce the costs of exit to some extent. On balance, we preferred our suggested approach.126

15.153 We recognized, however, that the approach taken in Scotland has the same aim of ensuring that service registrations reflect sustainable local bus services. We saw no evidence that the need to run new services for at least 90 days was a major barrier to entry in Scotland and considered it likely that operators had adjusted to the requirements there over time.

15.154 On balance, we concluded that there was unlikely to be sufficient additional benefit in recommending that the Scottish notice requirements be aligned with the remedy proposal for England and Wales. In practice, we concluded that the effects were likely to be sufficiently similar and that a different approach was not warranted when the additional benefits were considered.

- **Short-term registrations**

15.155 We considered whether operators should continue to have the ability to apply for short-notice registrations.127

15.156 In response to the provisional decision on remedies, we received feedback that the current process may not be working as well or as quickly as it should:

(a) Go-Ahead told us that in its experience short-notice registrations were, more often than not, not granted by Traffic Commissioners.128

(b) Arriva told us that the practice as to what was permitted as a short-notice change did at times vary between Traffic Commissioners. It considered that a recommen-

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126 In Scotland, a service also cannot be cancelled until it has been run for 90 days. As set out in paragraph 15.150, we preferred to allow a service to be cancelled with 56 days’ notice.
127 There are a number of circumstances in which an operator can make a registration application and ask that the registration be applied in less than the normal 56 days’ notice. Accepting such ‘short-notice’ applications is at the discretion of the Traffic Commissioner. Possible grounds include a response to an urgent and exceptional public passenger transport requirement. Further details can be found in the guides to Local Bus Service registration issued by VOSA which for England and Wales are under reference PSV353A and for Scotland is PSV 353A (Scotland).
128 Go-Ahead response to provisional decision on remedies, p10.
15.157 We noted these comments and took the view that the ability to make short-notice registrations, when appropriate, was an important means to minimize the scope for any adverse effects associated with longer notice periods. This is because operators that could demonstrate a genuine need to make changes more rapidly than in 90 days would be able to apply for a short-notice registration. Although not all operators raised these points, we were aware that the remedy could result in some additional demands on the existing short-notice process, and we took these into account in evaluating the proportionality of the remedy (see Appendix 15.8, paragraphs 56 to 59).

15.158 We did not find it appropriate to change the presumption to that of agreement to short-term applications, nor to establish a ‘second-tier’ notice process with specific timescales. Considering these applications is clearly the responsibility of the independent Traffic Commissioners and we did not seek to interfere in this decision-making role.

15.159 We noted the points made about the criteria for a short-notice application. But we also noted that the application form in use in England and Wales includes categories where:

(a) ‘The registration of variation of the service or part of the service is required in order to meet an urgent and exceptional public passenger transport requirement’; and

(b) ‘None of the above applies, but I wish to start/change/cancel a service for reasons which could not have been foreseen at 56 days notice’.

15.160 In both cases there is the opportunity for the operator to provide supporting details. In our view, these categories seem wide enough to incorporate a range of changes but the discretion in interpreting what qualifies rightly rests with the Traffic Commissioner.

15.161 We also noted that the conditions for making a short-notice change to a registration specified in the current Scottish guidance are different from those applicable in

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129 Arriva response to provisional decision on remedies, paragraph 3.10.
130 Stagecoach response to provisional decision on remedies, paragraph 4.7.
131 ALBUM response to provisional decision on remedies, p3.
132 EYMS response to provisional decision on remedies.
England and Wales. For example, we noted that the Scottish guidance excludes the condition for a short-notice change when the service timetable was changed by no more than 10 minutes earlier or later than registered. We decided that excluding this condition for making a short-notice change would reduce the scope for circumvention of this remedy option.

15.162 We concluded that operators should continue to have the ability to apply for short-notice registrations. In reaching this conclusion, we recognized that the DfT may wish, as part of any consultation on implementing changes to the registration, to consider aspects of the short-term process and we would encourage it to take account of the feedback we have received. It will be for the DfT to determine the appropriate detail of the process and resultant level of resources required to ensure that this short-term process remains fit for purpose, following any changes to the registration requirements. It may also wish to refine the specific terms of the criteria to take account of any wider considerations.

- **Circumvention risks**

15.163 Next, we considered whether any supporting measures would be necessary to address the risk of circumvention of this remedy by operators. We identified two potential circumvention risks with this remedy:

(a) the risk that an incumbent might seek to circumvent the 90-day period by either cancelling and then re-registering a service, and thereby being subject to the current 56-day notice period, or by registering a new service adding incrementally to the existing service; and

(b) the risk that operators might seek to respond to entry in a ‘tit-for-tat’ manner by registering a change to a service that had not yet come into operation.

15.164 A number of LTAs agreed that there was a possible circumvention risk if operators cancelled and then re-registered a similar service, thus being subject to 56 days’ rather than 90 days’ notice for the change.

15.165 Although, as set out in paragraphs 15.152 to 15.154, the registration rules are different in Scotland, there remain similar circumvention risks there. The Scottish Traffic Commissioner told us that:

resource issues do not allow staff in the Office of the Traffic Commissioner to compare every new application received with existing registrations, although it is likely that any such circumstance would be identified by a local authority during the 14 day period, or indeed another operator might point it out to us and that ‘whether something is a new service or a variation is a matter of degree’. She went on to tell us that if an operator were to breach the rules in Scotland, it would be running an unauthorized service and would be subject to a range of regulatory penalties from loss of repute at the high end to a warning at the low end.

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133 See forms PSV 350A and PSV 350A (Scotland).
134 We note, for example, that DfT previously consulted on changing bank holiday notification requirements (DfT response to provisional decision on remedies, paragraph 50). We do not have a strong view on this point and judge that this is rightly within the discretion of the DfT.
135 For example, response to provisional decision on remedies: TfGM, p16; Centro, paragraph 2.4; Nexus, paragraph 3.1.
15.166 The DfT told us that all parties would need to agree what should be properly regis-
tered as a new service and what should be a variation (for example, there could be
arguments that an extension or offshoot of an existing service could be a variation or
a new registration). If this was agreed, then the DfT believed that this would deter
such circumvention tactics being used.\textsuperscript{136}

15.167 We expect that LTAs, or other local operators, would be in a position to bring any
abuse of the registration requirements to the attention of the Traffic Commissioner,
who would be able to take appropriate enforcement action for running an unauthor-
ized service based on existing powers. To facilitate this process, we consider that
guidance issued by Traffic Commissioners could be helpful. Such guidance might
start with a default position that where a variation could have been used to achieve
the same effect as a cancellation and registration, then the variation should be used.
We recognize that there may be operational complexities that would also need to be
reflected in the guidance.

15.168 The second risk is that operators might seek to respond to entry in a ‘tit-for-tat’
manner by registering a change to a service that had not yet come into operation,
during the original notice period. This possibility is described in the following illus-
trative example:

\begin{quote}
Having given 14 days’ notice to the LTA, an entrant registers a new service and
gives 56 days’ notice to the Traffic Commissioner. In response, the incumbent,
having given 14 days’ notice to the LTA, registers a change to take place in
90 days. This registration prompts the entrant to make an application to change
its original registered service 90 days hence, before it has even started running
the originally registered service. The incumbent may then react to this before its
change to its own service takes place and so on.
\end{quote}

15.169 In practice the Traffic Commissioners told us that such overlapping changes were
relatively rare and tended to relate to errors in the original application. In our view,
anything other than correcting such errors could represent an undesirable use of the
registration requirements, as illustrated in the boxed example in paragraph 15.168.
We recognized that even if such behaviour rarely took place, the perception of the
potential for such behaviour could itself contribute to the barrier to entry.

15.170 We therefore concluded that it would be necessary to restrict further changes to
registrations during the currency of any notice period for a previous change to the
registration with the Traffic Commissioner to short-notice applications only (see para-
graph 15.162), which would be dealt with on an exceptional basis by the Traffic
Commissioner. This implies that while a registration application is pending, no further
application should be made in respect of the same service other than a short-notice
one.

\begin{itemize}
\item \textit{Frequent service registration requirements}
\end{itemize}

15.171 If an operator runs six or more buses per hour in each direction on a route, then there
is currently no requirement to register a timetable. Such services are described as
frequent services.\textsuperscript{137} We consider whether to recommend that the registration

\textsuperscript{136} DfT response to provisional decision on remedies, paragraph 47.
\textsuperscript{137} See Appendix 12.1, paragraph 51.
requirements for existing and future frequent services be amended to include the frequency of buses expressed in hourly bands.  

15.172 The aim of this remedy is to prevent an operator ‘flooding’ a route with buses in response to a competitor and this brings frequent services within the scope of the other two measures relating to notice periods for changes as described above. Should an operator wish to increase the frequency on a service beyond the registered band, it would need to make a change to the registration and would be subject to the 14-day pre-notification period to LTAs and a 90-day notice period to the Traffic Commissioners. This remedy therefore works in conjunction with the previous two measures. The monitoring of compliance to the registration would be made against each band.

15.173 Our analysis suggests that, as of October 2009, there were 651 services that had at least one hourly period with 12 or more buses operating in total (ie in either direction) and which could therefore be registered as frequent services without a detailed timetable.  Of these services, 119 operate in Scotland and only 14 in Wales. Of the total, 140 have a maximum frequency of more than eight buses per hour.

15.174 We considered that the frequency registration could be best expressed in bands to allow some flexibility for an operator to make operational changes without requiring an additional registration. Taking into account our analysis of frequent services, we invited comments in the provisional decision on remedies on an initial proposal that these hourly bands be expressed in the ranges of 6–8 buses per hour; 9–11 buses per hour; 12–14 buses per hour; and more than 15 buses per hour.

15.175 We received mixed views on the proposal. Some operators said that the proposed approach for registering frequent services which required strict compliance with the hourly frequency bands, with no allowance made for operational issues such as congestion, would be at best very burdensome for both operators and monitoring authorities and might even be unworkable. Moreover, it would restrict operators’ flexibility to respond to events unrelated to competitor behaviour, especially changing traffic conditions and changing customer demand, thus leading to a potential detriment for customers. ALBUM told us that the proposal ‘would cause undue bureaucracy, to no benefit’ and Go-Ahead told us that the proposals were unworkable and would lead to disproportionate customer hardship. However, other parties thought that operators could use existing frequent services to mask anticompetitive activities and that there would be a benefit of having more detail of frequent services for monitoring purposes.

138 For example, between 8am and 9am six to eight buses will run and then between 9am and 10am and so forth for each hourly period of operation.

139 We discuss the number of frequent services in the reference area in paragraph 12.43. Although these services have timetables which are sufficiently frequent that they could be registered as frequent services, it is not necessarily the case that they are in fact all registered as frequent, and some of these services may have published timetables.

140 For example, FirstGroup response to provisional decision on remedies, paragraph 4.4, and Go-Ahead response to provisional decision on remedies, paragraphs 3.18 & 3.20.

141 National Express also stated that the proposed changes to registration of frequent services would be too prescriptive and would make registrations and the operation of frequent services both very complex and very costly, and said that it would impose a significant administrative burden on operators. It thought that this would be particularly due to the fact that the current scheduling software could not automatically calculate the numbers required meeting the proposed bands, and therefore, certainly in the short term, the required calculations would have to be undertaken manually, which would imply a large administrative burden especially for large operators (see response to provisional decision on remedies, paragraphs 4.9 & 4.13); similarly the Confederation of Passenger Transport in its response to the provisional decision on remedies, p2.

142 ALBUM response to provisional decision on remedies, p3, and Go-Ahead response to provisional decision on remedies, paragraph 3.20.

143 For example, Rotala response to Remedies Notice, p5; TfGM response to Remedies Notice, p15; SPT response to Remedies Notice, p13, and to provisional decision on remedies, paragraph 3.7.
15.176 National Express told us that this remedy was too prescriptive and would make the operation of frequent services both ‘very complex and very costly’.\textsuperscript{144} It told us that the proposed bands made little sense as, for a typical urban route, the number of buses leaving the start of a service would be different from that arriving at a destination during the same period, when the frequency of a service was building up.\textsuperscript{145} It told us that its current scheduling software could not automatically calculate the numbers required to meet the proposed bands.\textsuperscript{146}

15.177 Other operators told us that there could be practical difficulties with the proposal but made suggestions to help overcome some of these problems. FirstGroup told us that a more reasonable and practical solution would be to allow an operator to select its own narrow overlapping frequency band.\textsuperscript{147} Similar points were made by other operators. Stagecoach, for example, said that if the bands could be expressed in overlapping bands such as 7–9 buses per hour and 8–10 and so forth, then the approach would be more proportionate.\textsuperscript{148} NCT made a similar request but also asked that using ‘clock face hours’ (ie 12 o’clock to 1 o’clock) be not made compulsory so allowing operators to choose the start of any hourly period of monitoring. This would give more flexibility.\textsuperscript{149}

15.178 FirstGroup suggested that VOSA and the Traffic Commissioners be asked to develop practical principles for monitoring to ensure that the proposal worked operationally and did not put at risk the ability of operators to deliver a punctual and reliable service as traffic conditions changed.\textsuperscript{150}

15.179 On balance, we decided to recommend that the registration requirements for existing and future frequent services be amended to include the frequency of buses expressed in hourly bands. We noted the comments about potential adverse effects, but concluded that these could be kept to a minimum by the design of the remedy and consequently we do not expect such effects to be material.

15.180 We noted that there are very few services operating in the higher frequency bands and most normally operate in the range 6–8 buses per hour. We decided that the default band, unless otherwise amended, should be the range 6–8 buses per hour and that only frequencies in excess of this need to be specifically detailed on the registration. This approach is likely to minimize the number of changes to existing service registrations that would otherwise be needed.

15.181 We agreed with the feedback that allowing overlapping bands is a sensible approach and we decided that operators should be able to nominate any band of frequencies, provided that this band was no more than three buses per hour wide: for example, 8–10 buses per hour and 9–11 and so on. We noted NCT’s comments, but did not have sufficient information to determine whether not applying ‘clock face’ measurement periods was practical for monitoring purpose. We decided that Traffic Commissioners and VOSA could best deal with this suggestion as part of the wider task of completing the detailed design of the registration requirements. In a similar vein, we did not seek to interfere with the existing practice direction on service standards, or to any other

\textsuperscript{144} National Express response to provisional decision on remedies, paragraph 4.9.  
\textsuperscript{145} National Express response to provisional decision on remedies, paragraph 4.11.  
\textsuperscript{146} National Express response to provisional decision on remedies, paragraph 4.13.  
\textsuperscript{147} FirstGroup response to provisional decision on remedies, paragraph 4.5.  
\textsuperscript{148} Stagecoach response to provisional decision on remedies, paragraph 4.23.  
\textsuperscript{149} NCT response to provisional decision on remedies. By this, it means that operators would be able to stipulate the hourly range to which a particular frequency related and this would give more flexibility.  
\textsuperscript{150} FirstGroup response to provisional decision on remedies, paragraph 4.5.
variant to such, which currently includes a requirement that there should be no more than a 15-minute gap between buses running a frequent service.\footnote{\url{www.dft.gov.uk/vosa/repository/PD%20standards%20for%20local%20buses.pdf}.}

- Other options relating to service frequency

15.182 We received feedback and suggestions on the various other remedy options we put forward relating to the frequency of services. We were not minded to pursue any of the other options\footnote{For example, we received a suggestion to require operators to split headways when changing a registration. As few routes overlap completely, we thought this might present operational difficulties and have unintended consequences for the non-overlapping parts of a route. We considered that this was not practicable. We also received a suggestion to stop publishing information about registrations in Notices and Proceedings as this would allow other operators to react earlier to changes to services made by competitors. We thought that the benefits of transparency of service changes to a number of stakeholders were important and that by extending the notice periods for registration, reactions would already be made slower, so we decided not to pursue this.\footnote{National Express response to provisional decision on remedies, paragraph 4.19.} \footnote{Stagecoach response to provisional decision on remedies, paragraph 4.24.} \footnote{Centro response to provisional decision on remedies, paragraph 2.12.} \footnote{Go-Ahead response to provisional decision on remedies, paragraph 3.23.}} as we have decided that these would not be practicable in light of the considerations in paragraphs 15.116 to 15.127.

- Code of Conduct

15.183 We have decided to recommend that a Code of Conduct be introduced to:

(a) provide a further incentive for compliance with the 1998 Act (see paragraphs 15.185 to 15.190); and

(b) deter operators from engaging in the types of operator behaviour we have described as cheap exclusion (see paragraphs 15.191 to 15.193).

15.184 We consider the role of a Code of Conduct in supporting each of these objectives and then consider practical issues relating to the application and administration of such a code.

- Compliance with the 1998 Act

15.185 The OFT suggested that the Code of Conduct could set out the requirement to comply with the 1998 Act and that as a result the deterrent effect might increase.

15.186 A number of parties expressed concerns about this requirement both in principle and in practice. National Express told us that this was a wholly unnecessary step as operators must already comply with the provisions of the 1998 Act.\footnote{National Express response to provisional decision on remedies, paragraph 4.19.} Stagecoach also disagreed with the requirement as the effect would be to impose an additional potential sanction for the breach of competition law and that there was no evidence that this would be a more effective deterrent than the 1998 Act itself.\footnote{Stagecoach response to provisional decision on remedies, paragraph 4.24.} Centro told us that non-compliance with the 1998 Act should be dealt with under that Act and if it was not working properly it should be modified accordingly.\footnote{Centro response to provisional decision on remedies, paragraph 2.12.}

15.187 Go-Ahead told us that it would be concerned if the Code of Conduct could involve a lower standard of proof than the OFT was required to apply under the 1998 Act and it would want due process followed.\footnote{Go-Ahead response to provisional decision on remedies, paragraph 3.23.} FirstGroup did not consider that Traffic Commissioners were the appropriate authority to make judgements on compliance with competition law. Instead it suggested that where the OFT made a finding that a bus operator had infringed competition law it may, if it so wished, recommend to the
relevant Traffic Commissioner that they made additional sanctions. Its submission was that this could only take place after all rights of appeal were exhausted.\textsuperscript{157}

15.188 We concluded that inclusion of this requirement in the Code of Conduct was likely to enhance the effectiveness of competition enforcement (see paragraphs 15.340 to 15.372) by increasing the potential costs to operators of proven breaches to the Chapter I and Chapter II prohibitions in the 1998 Act. This would increase the incentive on operators to comply with the 1998 Act and thereby reduce barriers to entry associated with extreme responses to new entry. We therefore agreed with the OFT that the requirement to comply with the 1998 Act should be included within the Code of Conduct.

15.189 We noted the points that were raised. It is not our intention that Traffic Commissioners be required to determine whether there had been an infringement of the 1998 Act. We also agreed that it would be inappropriate for Traffic Commissioners to take any action until all the rights of appeal of the operator concerned had been exhausted. But we did not consider it appropriate for the OFT to recommend additional action as had been suggested (see paragraph 15.187) as this could risk taking the OFT beyond its statutory functions under the 1998 Act. Rather we decided to recommend that the OFT notify all the Traffic Commissioners of the completion of any action and that all appeal routes had been followed. It would then be within the discretion of the Traffic Commissioners to impose additional sanctions (for the relevant operator in the Traffic Area(s) in which it operated) should they think this was appropriate and proportionate based on their own statutory duties and considerations.

15.190 Similarly, we considered whether Traffic Commissioners should also be able to take account of any civil cases that may have found an infringement of competition law. We decided that if the action showed that the Competition Act had been unambiguously breached and all appeal routes exhausted, Traffic Commissioners ought to be able to do so.

\begin{itemize}
  \item \textit{Cheap exclusion}
\end{itemize}

15.191 Many parties told us that, although they did not disagree that cheap exclusion was harmful, there was little evidence of it taking place.\textsuperscript{158} We were told that such behaviour in any case would come under existing regulations or laws.\textsuperscript{159} However, almost all operators expressing a view told us that they would be prepared to sign up to a Code of Conduct dealing with cheap exclusion and that this should apply to all operators.\textsuperscript{160} Lothian Buses was an exception as, although it did not object to the idea of a Code of Conduct in principle, it did not think that there was evidence of cheap exclusion taking place in Edinburgh, and as a result a Code of Conduct was not needed there.\textsuperscript{161}

15.192 Some parties expressed concerns about the content of a Code of Conduct. Go-Ahead told us that any Code of Conduct would need to be carefully drafted to ensure that it was clear that it only applied to cheap exclusion and that it was clear what constituted a breach. It wanted to ensure that there was no scope for ‘regulatory creep’.\textsuperscript{162}

\textsuperscript{157} FirstGroup response to provisional decision on remedies, paragraphs 4.8 & 4.9.
\textsuperscript{158} For example, Go-Ahead response hearing summary, paragraph 21; Nexus response hearing summary, paragraph 22; Lothian Buses response hearing summary, paragraph 18.
\textsuperscript{159} For example, Arriva response to Remedies Notice, Section G; SPT response hearing summary, paragraph 23.
\textsuperscript{160} This was subject to the detail of the Code of Conduct and on the understanding that it covered aspects of cheap exclusion as defined by the CC in the provisional findings. Rotala, for example, suggested that there could be core provisions for all operators and increased provisions for larger operators (response to Remedies Notice, p7).
\textsuperscript{161} Lothian response to provisional decision on remedies, paragraph 4.10.
\textsuperscript{162} Go-Ahead response to provisional decision on remedies, paragraph 3.22.
Stagecoach expressed a similar concern about the lack of detail provided about what a Code of Conduct would cover. Nexus considered that what might be appropriate for a rural market might not be so for a metropolitan or urban one. It thought that consideration should be given to LTAs establishing and enforcing a Code of Conduct as part of a partnership agreement. TfGM told us that it already had a Code of Conduct in place, parts of which might be a useful template, and also emphasized the need for a Code of Conduct to reflect different local market issues. Centro said that it would prefer a ‘guidance note’ to deter this sort of behaviour and that breaches would be potential issues for operator repute.

15.193 We noted these comments and agreed that the Code of Conduct would need to be carefully drafted. In our view, the development of such a code is both achievable and desirable. We note that there has been general agreement that restrictions on cheap exclusion are likely to be unambiguously beneficial. In our view, the Traffic Commissioners are likely to be best placed to specify the conduct to be proscribed by a Code of Conduct, in light of the types of behaviour summarized in paragraph 8.275 to 8.277.

- **Application and administration of a Code of Conduct**

15.194 Many parties thought that the Traffic Commissioners would be best placed to own and enforce the Code of Conduct. A suggestion was made that they should develop this in consultation with industry bodies.

15.195 The DfT told us that it supported in principle the introduction of a Code of Conduct. It said that it would welcome the views of the Traffic Commissioners on the proposal that it be introduced and enforced by them. If this were to be the case, it considered that the Code of Conduct would need to be explicit on what constituted unacceptable behaviour to avoid protracted and time-consuming disputes involving the Traffic Commissioners. The DfT also encouraged the consideration of a voluntary, perhaps operator-led, Code of Conduct in advance of required legislation to increase the mandate of Traffic Commissioners.

15.196 The question of the sufficiency of resources for Traffic Commissioners to monitor and enforce a Code of Conduct was raised by other parties. PTEG questioned the ability of the Traffic Commissioners, given their current remit and limited resources, to monitor adherence to a Code of Conduct and take into account the different issues of relevance to each area. TfGM also thought one of the main issues with this remedy was the ability of Traffic Commissioners to resource their activity and to monitor adherence and that it would be necessary to understand what the Government’s reaction to the remedy would be.

15.197 Bearing in mind the concerns about resources, we considered whether a Code of Conduct could be subject to self-regulation. In our view, without effective monitoring and enforcement, the Code of Conduct would not be effective. We decided that the

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163 Stagecoach response to provisional decision on remedies, paragraph 4.30.
164 Nexus response to provisional decision on remedies, paragraph 3.2.
165 TfGM response to provisional decision on remedies, p16.
166 Centro response to provisional decision on remedies, paragraph 2.13.
167 For example, FirstGroup response hearing summary, paragraph 31; Go-Ahead response hearing summary, paragraph 21; Stagecoach response hearing summary, paragraph 24; Metro response hearing summary, paragraph 25.
168 For example, ALBUM response hearing summary, paragraph 20; NCT response hearing summary, paragraph 22.
169 DfT response to provisional decision on remedies, paragraphs 54 & 55.
170 PTEG response to provisional decision on remedies, paragraph 10.6.
171 TfGM response to provisional decision on remedies, p16.
172 The DfT suggested that we consider self-regulation as an option for the Code of Conduct (DfT response hearing summary, paragraph 34).
The Code of Conduct was best introduced as a legal requirement and then formally monitored and enforced by the Traffic Commissioner.

15.198 We decided to recommend that the Traffic Commissioner should have a duty to consult with operators, and other stakeholders, before introducing the Code of Conduct. In developing the monitoring and enforcement requirements in this way, we believe that the risk of duplication or overlap of duties is minimized, that this provides a clear link to the enforcement powers of the Traffic Commissioner and that the specification will be clear to operators. To further encourage compliance, we decided to recommend to the DfT that, as part of its current review of BSOG in England, it considers ways of incentivizing compliance with the Code of Conduct (see Figure 15.7 in paragraph 15.423). This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

15.199 We noted that there are a number of stakeholders (including local operators and LTAs) which are in a position to bring complaints about breaches of the Code of Conduct to the attention of the Traffic Commissioner. By setting out clearly in the Code of Conduct what would constitute a breach, we expected that such complaints would be easier for such parties to make.

15.200 We considered whether that the mandate of the Traffic Commissioner would need to be enhanced to ensure the effective introduction and enforcement of the Code of Conduct. We noted that current sanctions open to Traffic Commissioners for breach of existing regulations range from a warning to a withdrawal of an operator’s licence. Several parties told us that breach of a Code of Conduct would be considered a matter of operator repute, which is a circumstance that could result in the withdrawal of an operator’s licence under current regulations. However, the Traffic Commissioners told us that using ‘operator repute’ to take action was a ‘blunt instrument’ and a better solution might be to ensure that a breach of the Code of Conduct could result in service registration(s) being withdrawn. We agreed with this submission and therefore recommend that the mandate of the Traffic Commissioners be suitably amended to allow them the power to withdraw service registrations in the event of a breach.

15.201 We concluded that cheap exclusion is relevant to all operators regardless of size, geography or whether they are an incumbent or an entrant. Although the incidence generally might be low, there is a possibility of this behaviour in any part of the reference area. We also took the view that the general existence of the Code of Conduct would have a helpful wide deterrent effect. We decided to recommend that the Code of Conduct should apply to all types of operators in all parts of the reference area.

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173 Cheshire West and Chester, in its response to the provisional decision on remedies, thought that LTAs and service users should be consulted.
174 For example, Metro thought that LTAs would be well placed to advise Traffic Commissioners on local circumstances (response hearing summary, paragraph 25) and the Deputy Senior Traffic Commissioner thought that Traffic Commissioners and LTAs would need to work in partnership to identify behaviour of concern (response hearing summary, paragraph 18).
175 For example, FirstGroup response hearing summary, paragraph 31; Go-Ahead response hearing summary, paragraph 21; NCT response hearing summary, paragraph 22.
176 For example, Scottish Traffic Commissioner response hearing summary, paragraph 8; Deputy Senior Traffic Commissioner response hearing summary, paragraph 17.
177 The most effective way of achieving this might be to attach the conditions of the Code of Conduct to new or changed registrations.
Protection for municipals

15.202 We considered whether to recommend that any local authority wishing to sell a municipal business could apply for a restriction on any new registrations or changes to existing registrations in the area of the operation of such business for a limited period of time. This could be used to protect the business from the potential for destabilizing competition which might undermine the sales process and the viability of the business for an independent purchaser.

15.203 There were concerns expressed about allowing protection for independent businesses. There was more support for protection for municipal businesses. ALBUM told us that once a sale of a municipal business had been announced, protection was required until the sale was agreed and contracts had been exchanged. Lothian Buses thought that this protection should be limited to a reasonable period, and NCT suggested to us that 90 days should be more than enough time to sell a bus company if that was the real intent.

15.204 Some parties thought that the proposals might give an undue advantage to municipal operators. Go-Ahead thought that this proposal was aimed more at protecting public money than addressing the AEC. It thought it unfair that a municipal should benefit in this way but not an independent commercial operator. Stagecoach thought that the system could be 'gamed' by a municipal operator and that during a sale process it could increase services and its competitors would be unable to respond. It believed that safeguards to protect against this asymmetry were required. It also did not think that the remedy should apply to reductions in services, deregistrations or tendered services. Cheshire West and Chester Council thought that it was important to ensure that there was impartiality in the process as the LTA may also be the local authority selling the municipal operator.

15.205 We were not persuaded that any protection should be given to independent businesses being sold in addition to the other remedies on operator behaviour we have decided to introduce. However, we decided that there were special factors around the sale of municipal businesses that made the case for protection stronger. This is because:

(a) A more open and transparent sales process is likely to be necessary to ensure public accountability. In particular, these businesses are 'arm's length' from the local authority owner and it needs to be shown that best value is achieved.

(b) There is a risk of potential loss to public finances, particularly if, as sometimes occurs, the sale process takes place when these businesses are already weak.

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178 Because of the tendency for head-to-head competition to sometimes be unsustainable, and because operators may sometimes be able to take advantage of this to weaken a competitor or force them to exit, the possibility arises that commercial operators might seek to take measures to manipulate the sales process to their advantage. This could take the form of a commercial operator in the area weakening the municipal operator, such that it can be purchased more cheaply and is less likely to be attractive to rival bidders, or if the commercial operator does not itself purchase the municipal business, it is weakened as a competitor under a different owner. This would then have the effect of weakening head-to-head and potential competition in that area.

179 For example, Arriva response to Remedies Notice, section H; and FirstGroup response to Remedies Notice, p23.

180 Lothian Buses response to Remedies Notice, paragraphs 115 & 116; and NCT response hearing summary, paragraph 23.

181 Go-Ahead response to provisional decision on remedies, paragraph 3.26. It also told us that the proposal might be counter to the Treaty on the Functioning of the European Union but was not in a position to provide any evidence to support this.

182 Stagecoach response to provisional decision on remedies, paragraph 4.32.

183 Cheshire West and Chester response to provisional decision on remedies.

184 We note that following the Local Transport Act 2008 (the 2008 Act) there is no longer a requirement to notify the Secretary of State prior to sale but even so the likelihood is that the sales process will be open.
15.206 As there are a relatively limited number of possible municipal sales processes, we decided that this was an area where the Traffic Commissioners would have the capacity to act and to intervene.

15.207 We decided that the Traffic Commissioners should have a duty to respond to a request to restrict service registrations in the geographic area of operation of the municipal and which overlap in any way with the existing services operated by the municipal. We agreed that it would be unfair to restrict the actions of the competitors to a municipal and to allow it to continue to make service changes and particularly increase service frequencies. As a result, we decided that the restriction would also apply to the municipal. We considered that this might also help to ensure that the owner of the municipal appreciated the impact of the restriction it was asking for.

15.208 We are aware that it can be difficult to define the precise moment at which a sales process starts and that protection may be required from the point at which a firm proposal to sell a municipal business becomes public knowledge. As a result, we concluded that it would be appropriate for the owner of the business to decide when it thought that protection was warranted. This should only be in circumstances where it had received a clearly documented mandate to progress the sale of the business.

15.209 We did not consider that it would be necessary for Traffic Commissioners to apply any discretion in responding to a request provided the request was properly authorized and was for the purpose of achieving an orderly sales process. To the extent that the Traffic Commissioner was so satisfied, any registrations or changes to registrations would not be accepted for a defined period of time. We did conclude, however, that it would be appropriate for any deregistration (to exit totally a service in the specified area) to be allowed as an exception to the rule.

15.210 We decided that the maximum period of protection that could be requested was 90 days. We recognize that this is in addition to our recommended period of 14 days’ prior notice to LTAs and the existing 56 days’ notice for a new service (or our recommended 90 days’ notice for an amended service). In our view, this time period is sufficient to allow a serious and credible sales process to be completed. We further recommend that no more than one period of protection in any two-year period (measured from the start of any agreed period of protection) should be allowed in order to retain the incentive to run and complete a serious sale process.

15.211 In order to minimize the risk of distortions as a result of the restrictions, we decided that a Traffic Commissioner should be allowed to accept a change to a registration during the period of restriction if this was agreed by the LTA (in consultation with the local authority owner of the business where different). Such agreement would be facilitated by the 14 days’ pre-notification to LTAs that we have described in paragraphs 15.129 to 15.139. This period would enable the LTAs to review any exceptions to the restriction. This might be particularly appropriate in the case of supported services.

- Scope of remedy

15.212 We considered the appropriate geographic scope of these remedies. We concluded that this remedy should apply throughout the reference area, subject to the differences set out in Figure 15.2 in paragraph 15.110 between England, Wales and Scotland.

15.213 This is for two reasons. First, the feature relating to customer conduct—which in part gives rise to the problems associated with competition not being sustained—and the barriers to entry and expansion associated with the expectations of post-entry
competition are present to some extent in every market. Second, we did not consider that it would be practicable for the registration process, or the terms of a Code of Conduct, to vary significantly within nations. Such variation would be likely to lead to confusion among bus operators and other market participants.

**Implementation of remedy**

15.214 We considered how the remedy should be implemented.

15.215 We decided to make a number of recommendations to others to implement the remedy. We judge this to be the most effective way of implementing the remedy. The DfT indicated to us that at least some aspects of this remedy would probably require changes to primary legislation. It told us that this included the Code of Conduct and Protection for Municipals. It said that the changes to the registration process could probably be undertaken through secondary legislation on the basis that we were not, for these purposes, extending the powers of Traffic Commissioners to refuse registration applications. 

15.216 We noted above that the changes will most likely involve a more detailed review of existing aspects of the registration process, for example short notice registrations, to make sure that these are fit for purpose given the greater demands likely as a result of the new requirements. Operators have made a number of points of detail which can be picked up as part of any review.

15.217 The changes that we seek to the registration process in England and Wales are incremental to the existing registration process and, as a result, are best made and implemented by the existing bodies that oversee and operate that process. We noted that a consultation about some changes to notice periods was undertaken by the previous UK Government in 2010 and that the current UK Government has yet to decide whether those proposals would be implemented. We have had encouraging discussions with the DfT about the possible range of remedies. We are aware that the DfT will consult the Welsh Government in determining a formal response to our remedies.

15.218 We recognized that matters relating to local bus service registration in Scotland are devolved to the Scottish Government. We have had a similar positive dialogue with the Scottish Government during the investigation and it emphasized that it would want to be satisfied that the remedies were relevant in Scotland.

15.219 While recognizing the devolved nature of certain decisions in relation to local bus service registration, we would highlight the benefits of a common approach between England, Scotland and Wales, for example on frequent service registration and the Code of Conduct.

15.220 In our judgement, Traffic Commissioners are best placed to introduce, monitor and enforce the Code of Conduct (see paragraph 15.197). Initial work to develop the content of a Code of Conduct could be initiated without legislative change. However, a change to Traffic Commissioners’ mandate would be required to introduce, monitor

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185 Paragraph 14.15.
186 DfT response to provisional decision on remedies, paragraphs 47 & 56.
187 For example, in paragraph 143(b) FirstGroup raised the distinction between receipt and acceptance of a registration application by Traffic Commissioners, suggesting that they be the same. We noted that the coincidence of the dates appeared to be the practice already in Scotland and thought that the DfT may wish to consider this. If, as FirstGroup said, this period was used to consult LTAs, then it is no longer required, and whether the process changes or not may not be significant. However, we imagine that there is a certain amount of checking of applications that may still be required.
and enforce such a code. Such a change could only be introduced by the respective
governments of the nations.

15.221 The role of LTAs is determined by guidance and regulations established by national
governments and local priorities and again a recommendation is the most appro-
priate way of implementing the remedy.

Access to bus stations

Summary of remedy

15.222 Figure 15.3 summarizes our remedy in relation to access to bus stations.

**FIGURE 15.3**

Summary of remedy relating to access to bus stations

<table>
<thead>
<tr>
<th>We have decided to introduce the following remedy to enable operators to have fair access to bus stations:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• An Order on local bus operators which manage relevant bus stations (‘Managers’) obliging them to provide third party operators (‘Users’) access on fair, reasonable and non-discriminatory (FRND) terms. This includes access to stands and layover bays, as well as access to facilities for drivers, and to facilities for publicizing services and timetables.</td>
</tr>
<tr>
<td>• Managers will be required to publish Conditions of Use for the bus station which should include information about: stand and layover capacity; charges and discounts for use of the bus station (including charges for use of bus stands for departures and layover bays); and the policy for allocating capacity and for allowing access to facilities. (See Appendix 15.4, Part 1, for further detail.) The Manager should consult with stakeholders (including Users and the LTA) before publishing these Conditions of Use, and prior to making subsequent amendments to them.</td>
</tr>
<tr>
<td>• The Manager will be obliged to enter into a written contract with each User, setting out the relevant conditions of use for the bus station.</td>
</tr>
<tr>
<td>• The Manager should publish procedures for the timely resolution of disputes concerning bus station access and charges.</td>
</tr>
<tr>
<td>• In the event of a dispute concerning the level of departure charges, the Manager will be required to show that charges have been calculated on FRND principles. (See Appendix 15.3, Part 3, for our guidelines on setting charges.)</td>
</tr>
<tr>
<td>• In most cases we would expect disputes to be resolved between the Manager and User. However, in circumstances where a User is not satisfied with the outcome of a dispute, it may escalate the matter as follows:</td>
</tr>
<tr>
<td>o An independent expert may be appointed to resolve disputes over charges.</td>
</tr>
<tr>
<td>o The LTA (or in some circumstances, another appropriate authority or independent expert) may be asked to decide disputes concerning other issues, such as capacity, stand allocation or access to facilities.</td>
</tr>
<tr>
<td>• In the event of a dispute, the Manager will be obliged to provide timely and relevant</td>
</tr>
</tbody>
</table>
Managers will be obliged to keep a formal record of all disputes and to report them annually to the relevant LTA. In addition, the OFT may require the provision of this information from a Manager at any time.

How this remedy addresses the AEC and/or resulting customer detriment

15.223 In paragraphs 9.128 to 9.161, we identified that some Managers adopt practices which can restrict entry, including:

(a) high and/or discriminatory departure charges;
(b) lack of transparency in pricing, with possible refusal to quote a departure charge;
(c) discriminatory allocation of stands and/or layover capacity;
(d) poor management of stand capacity and more generally restrictions on the capacity available to new entrants; and
(e) restrictions on the ability of drivers to access certain facilities available at the bus station.

15.224 To address the barriers to entry and expansion arising from these practices, we developed an access remedy such that third party operators using or wanting to use a bus station (‘Users’) are able to gain access to bus stations on fair and reasonable terms and are not discriminated against by bus station managers. We term this an ‘FRND access remedy’. This is likely to improve the ability of existing Users to offer competing services and, in particular, give confidence to potential Users that their entry plans would not be put at risk by discriminatory behaviour.

15.225 Responses from parties were generally supportive of an FRND access remedy, which many considered to be both necessary to ensure a consistent and fair access to bus stations in the reference area, and proportionate. Most respondents considered that FRND provisions were an effective remedy for the specific problems relating to bus stations, as identified in paragraph 15.223.

Design issues

15.226 Below we set out how we considered the design issues of our remedy under the following headings:

(a) scope of definition of a Relevant Bus Station (see paragraphs 15.227 to 15.235);
(b) addressing the diversity of local circumstances (see paragraphs 15.236 to 15.241);
(c) access issues: stand and layover capacity—definition and allocation (see paragraphs 15.242 to 15.248);
(d) access issues: access to driver facilities (see paragraphs 15.249 to 15.254);
(e) access issues: access to marketing facilities (see paragraphs 15.255 to 15.257);
(f) charges for using a bus station (see paragraphs 15.258 to 15.269);

(g) dispute resolution procedures (see paragraphs 15.270 to 15.277); and

(h) implementation and monitoring (see paragraphs 15.278 to 15.290).

- **Scope of definition of a Relevant Bus Station**

15.227 We considered how to define a ‘bus station’ for the purposes of this remedy and to which bus stations it should apply. The 1985 Act defines bus stations in the following terms: ‘a parking place which may be used by public service vehicles (including any such parking place which forms part of any interchange facilities for enabling passengers travelling by one means of transport to continue their journey by another)’. It also includes ‘associated facilities’, defined as: ‘in relation to a bus station, any amenities or facilities provided for use in connection with that station’. None of the respondents to the provisional decision on remedies raised any concerns with this definition. We adopted this definition for the purposes of our remedy.

15.228 In specifying which bus stations should be covered by this remedy, we considered the views we received from the parties:

(a) The following parties: Arriva, Stagecoach, The TAS Partnership Limited (TAS), SPT, RTPs Scotland, ATCO, CPT and EYMS, told us that the remedy should apply to all bus stations, regardless of who owns or manages the bus station (including bus stations owned and managed by local authorities and private companies).

(b) Some parties (Rotala, Bath Bus Users Group, B&NES and CILT) told us that it should apply to all privately-owned bus stations. PTEG welcomed the principles of the remedy, but stated that this remedy would not address the AEC in PTE areas where there were a few operator-owned bus stations.

(c) Some third parties (SEStran, SYPTE and Nexus) told us that it should apply only to bus stations which were privately owned and/or managed by local bus operators.

(d) Other third parties (CILT and Bus Users UK) argued that bus station operators should not be required to make the facilities they owned available to other operators. CILT said that local bus operators that saw a commercial opportunity to acquire and develop their own bus stations at their own expense should not then be required to make them available to others.

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188 ATCO response to provisional decision on remedies, paragraph 7.
189 CPT response to provisional decision on remedies p2.
190 EYMS response to provisional decision on remedies, p3.
191 Rotala response to remedies notice, paragraph 9.
192 Bath Bus Users Group response to remedies notice, paragraph 8.
193 B&NES Council response to remedies notice, p5.
194 CILT response to provisional decision on remedies, paragraph 11.
195 PTEG response to provisional decision on remedies, paragraph 13.1.
196 SEStran response to Remedies Notice, p4.
197 SYPTE response to Remedies Notice, p12.
199 See response to Remedies Notice, Issues for comment 8a).
200 CILT response to Remedies Notice and Bus Users UK response to Remedies Notice.
201 CILT response to Remedies Notice, paragraph 28.
15.229 The barrier to entry and expansion that we have identified is limited to those bus stations managed by bus operators. Although we received some suggestions that private companies which managed bus stations (mainly at airports and railway stations) might discriminate between their customers, we took the view that a remedy that imposed requirements on managers of bus stations other than bus operators would be outside the scope of our findings, and therefore not within our power to remedy.

15.230 We do not accept the argument that bus station operators should not be required to make the facilities they own available to others. Our understanding is that local bus operators have generally not deliberately built, acquired and developed bus stations as a commercial opportunity, rather this has tended to arise as a result of privatization. We understand that the redevelopment of operator-owned bus stations can sometimes be funded by local authorities or other bodies (eg the redevelopment of Wakefield bus station, which was part-funded by the European Regional Development Fund and Metro). However, we decided that Managers should be entitled to recover a fair and reasonable proportion of the costs they incur in providing bus station facilities through charges (see paragraphs 15.258 to 15.269).

15.231 We also considered comments from parties that this remedy should only apply to bus stations in specific geographic areas:

(a) ALBUM told us that this remedy should apply as and when required, and that it was in some places beneficial to pick up customers from the streets (although it also mentioned areas where this was not possible).\(^{202}\)

(b) Stagecoach told us that the remedy should only apply to bus stations where access was important.\(^{203}\)

(c) FirstGroup told us that it should only apply where: there was sufficiently high concentration; the bus station was an essential facility; and the existing access regime gave rise to a detriment to competition.\(^{204}\)

(d) Go-Ahead argued that the remedy should only apply to those markets which displayed all three features which, in the CC’s provisional report, gave rise to an AEC and where access to bus stations was identified as a barrier to entry.\(^{205}\)

(e) Lothian Buses told us that it believed remedies should only be imposed where customers were suffering a particular detriment, and the remedy would mitigate or resolve an identified customer detriment. It may therefore only be appropriate to impose this remedy in markets in which there is an identified problem with access to bus stations.\(^{206}\)

(f) NCT told us that it had not experienced problems at Nottingham and that the remedy should therefore not apply to bus stations in the areas of Nottingham. NCT uses two bus stations, where no departure charges are payable. These bus stations are both managed by the local council, and would therefore fall outside the scope of our remedy in any case.\(^{207}\)

\(^{202}\) ALBUM response to Remedies Notice, Issues for comment 8(a).

\(^{203}\) Stagecoach response to provisional decision on remedies, paragraph 5.3.

\(^{204}\) FirstGroup response to Remedies Notice, Annex 3, Issues for comment 8.

\(^{205}\) Go-Ahead response to Remedies Notice, paragraph 4.4.

\(^{206}\) Lothian Buses response to Remedies Notice, paragraphs 3, 118 & 120.

\(^{207}\) NCT response to Remedies Notice, paragraphs 3.71–3.73.
15.232 Our findings and therefore the scope of our remedy are not conditional on the bus station being a so-called ‘essential facility’ (as argued by FirstGroup) because competition may be distorted where a third party operator is put at a disadvantage by the manner in which a Manager grants access to its bus stations, even if it is not totally prevented from operating in the area.

15.233 Our view is supported by the 1985 Act which recognized the importance of bus stations in the supply of bus services and the potential for the local authority owners of bus stations to distort the competitive process at a time when they also owned major local bus operations. This was addressed by requiring all PTEs and local authorities to provide fair and non-discriminatory access to the bus stations they owned. We understand that as a result, PTEs and local authorities have put in place processes to meet their statutory duties under the 1985 Act.208 For this reason, our remedy does not need to cover bus stations owned by local authorities or PTEs and managed under contracting-out powers.

15.234 In Section 9, we investigated the ability and incentives of operators to use their control of bus stations to raise barriers to entry. We found that where an incumbent bus operator manages a bus station, it has both the incentive and ability to restrict a User’s access to that bus station (including through the price it charges for access). This distorts competition and we have seen examples of how this distortion manifests itself in practice where there has been recent entry (see paragraphs 9.135 to 9.157).

15.235 We therefore decided that our remedy should apply to bus stations where the Manager has an ability and incentive to manipulate access to the disadvantage of the User. We term these the ‘Relevant Bus Stations’ and define them as those bus stations that are managed by a local bus operator, other than where the bus station is managed under local authority or PTE contracting-out powers.209 We estimate that there will be up to 80 Relevant Bus Stations.

- **Addressing the diversity of local circumstances**

15.236 We considered how our remedy could be structured to take into account local conditions. We note that variations between bus stations are likely to include:

(a) the nature of the facilities available to the Manager (eg office facilities and staff canteens), Users and passengers;

(b) the nature of the user base (eg the balance between coach and/or local bus operators); and

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208 The 1985 Act sets out the requirements on PTEs and local authorities in relation to the provision or operation by them of bus stations and any associated facilities, including charges for their use. Section 82(1) of the 1985 Act prohibits PTEs and local authorities from discriminating, directly or indirectly, against any holder or class of holder of PSV operator’s licence when exercising their powers in relation to the above. This prohibition also applies to any person to whom a PTE has contracted out the operation of a bus station provided by it under its contracting-out powers (section 82(3)). Where a bus station is owned by a local authority, but leased to a local bus operator, the prohibitions set out in section 82(1) will not apply to the local bus operator managing the bus station unless the management of the bus station is undertaken by the local bus operator under the local authorities’ contracting-out powers.

209 Using a similar approach to the assessment set out in Appendix 15.3, we also considered indicators of the extent of effective competition in Urban Areas with bus stations that were privately owned and managed by a bus operator. On average, we found that the proportion of services on routes in category 1, routes in categories 2, 3, 4 or 6, and routes in category 5 (see Appendix 11.4) was broadly similar in these areas to the proportions observed for all Urban Areas considered together, although on average these Urban Areas had a slightly greater proportion of routes in category 1 than the median Urban Area in the reference area. We found that in nearly all of those Urban Areas with bus stations that were privately owned and managed by a bus operator, a significant proportion of services were operated on routes in category 1—that is, routes that we are able to identify as being highly unlikely to face effective head-to-head competition. For example, in 40 of the 46 Urban Areas identified, more than 20 per cent of services were accounted for by category 1 routes.
the amount of bus stand and/or layover capacity.

Go-Ahead made a number of points about the level of flexibility required and told us that the remedy must enable the bus station operator to take account of health and safety issues; must not be overly prescriptive; and must leave scope for negotiation. Go-Ahead argued that an overly prescriptive approach might lead to Users paying higher departure charges than they currently did.

In designing our remedy, we have sought to balance the advantages of giving clear and unambiguous rules which will reduce the scope for gaming with the need for sufficient flexibility to take account of local conditions. Both of these objectives are relevant to the development of a set of guiding principles which Managers should use to provide access and set charges on an FRND basis taking into account the specific circumstances at each Relevant Bus Station.

We have therefore decided that, for each Relevant Bus Station:

(a) The Manager must publish the Conditions of Use for the bus station in a prominent place at the bus station and where applicable on the bus station’s website. The Conditions of Use should include information about: stand and layover capacity; charges and discounts; and the policy for allocating capacity and for allowing access to facilities, in addition to what actions constitute a material breach of the Conditions of Use. We set out our template for the Conditions of Use in Appendix 15.4, Part 1.

(b) The Manager must consult with local stakeholders (including Users and the LTA) before publishing its bus station’s Conditions of Use, and prior to making subsequent amendments to them.

(c) The Conditions of Use must also set out procedures for the timely resolution of disputes concerning bus station access and charges. Further details of these Dispute Resolution Procedures are set out in paragraphs 15.270 to 15.277.

In its response to the provisional decision on remedies, Go-Ahead told us that it considered the ‘requirement to publish upfront Conditions of Use’ to be disproportionate since it would ‘impose a significant burden on bus station owners’, in particular in relation to departure charges and discounts, where Managers would ‘be obliged to incur significant costs at the outset in instructing lawyers and economists to ensure that any such charges are defensible, as well as consulting with stakeholders prior to their publication’. Go-Ahead suggested that a ‘preferable approach’ would be for Managers to abide by FRND principles without publishing their bus stations’ Conditions of Use, with independent experts possibly being brought in to resolve any disputes. By contrast, Rotala, in its response to the provisional decision on remedies, told us that the ‘FRND approach will significantly improve the transparency of and availability of information about charges’.

Whilst we recognize that there will be one-off and ongoing costs to the Manager in relation to the publication of its Conditions of Use, the requirement for the Manager

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210 Go-Ahead response to Remedies Notice, paragraph 4.4.
211 This issue was emphasized by Rotala: ‘Clearly the main issues relate to equality of charging, equality of access to both the bus station itself and the most suitable stands for particular destinations. But any claimed universal definition for the definition of station capacity and how stand allocation should be conducted at the macro level will inevitably be arbitrary and will disregard variables unique to each stand and group of users within any location’. Source: Rotala response to Remedies Notice, paragraph 9(c).
212 Go-Ahead response to provisional decision on remedies, paragraphs 4.2 & 4.3.
213 Rotala response to provisional decision on remedies, paragraph 26.
also to consult local stakeholders in relation to the Conditions of Use is an integral part of our remedy which is essential for it to be effective and helps tailor the FRND access remedy to meet the local circumstances of the bus station and the local needs of its stakeholders. Furthermore, the publication of the Conditions of Use will also provide Users with greater (and, in our judgement, much needed) transparency in relation to how Managers allocate bus station capacity between Users and how they set charges. Under Go-Ahead’s proposal, we note that there would be no stakeholder participation in determining how Managers should interpret and abide by the FRND principles of our remedy. We therefore concluded that it was necessary for Managers to publish their Conditions of Use.

- **Access issues: stand and layover capacity—definition and allocation**

15.242 In paragraphs 9.141 to 9.146 and Appendix 9.3, we set out examples of where a rival operator’s ability to compete had been adversely impacted by the restriction of bus station access (eg through allocation of bays or restricting publicity).

15.243 The evidence we received shows that the incentives for a Manager to develop and manage a bus station efficiently may be dulled. This can manifest itself through longer dwell times taken by the Manager’s buses at the bus station; and/or the inefficient use of layover space. The Manager may also have the incentive and ability to allocate badly located stands to its competitor.

15.244 We received the following comments from third parties concerning bus station access issues:

(a) Wayne Arthur, Worcestershire County Council (WAWCC), told us that the owner of the bus station must have an obligation to provide capacity for a new entrant subject to reasonable constraints. Where a competing service was introduced, there should be access to stands in a similar location to that operated by the incumbent operator. The owner of the bus station should also have a statutory obligation to manage adherence to times at stands indicated in registered timetables. WAWCC told us that the frequent service provisions should be removed, and that all arrivals and departures should be registered with punctuality targets reflecting the frequency of the service. WAWCC added that it did not make sense to have a 6-minute window on a frequent service. WAWCC also told us that there should be guidelines on effective scheduling of capacity at bus stations, eg in relation to how many arrivals per hour per stand, etc.²¹⁴

(b) TAS told us that typically, bus station codes of conduct specified a minimum time interval between departures from a given stand of 5 minutes in order to avoid congestion and the likelihood of double-parking. It should also arrange stands for services by corridor or destination, rather than by operator. This limited any incumbent operator as much as a newcomer.²¹⁵

(c) Nexus told us that a series of advertised principles could be established and include the following: the agreed timescale between individual departures from each stand; wherever possible, stands would be allocated based on compatibility of corridors and common areas would be grouped together. Thus stands should be publicly allocated to serve a particular direction; they would be allocated on a first-come, first-served basis; when the preferred stand was at capacity the oper-

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²¹⁴ WAWCC response to Remedies Notice, comment on paragraph 48.
²¹⁵ TAS response to Remedies Notice, comment on Issues for comment 8, part (c).
ator would be given the opportunity to re-time or would be offered the nearest available stand, and would be ‘moved’ as soon as capacity became available.216

15.245 A number of parties stressed the importance of recognizing that some bus stations might not have enough spare capacity and that the remedy should provide for flexibility in the allocation of spare capacity:

(a) FirstGroup told us that there needed to be a mechanism for the Manager to make a good faith judgement in respect to actual bus station capacity.217

(b) Stagecoach’s view was that a new entrant should not have the right to displace an incumbent making genuine use of capacity.218

(c) ALBUM said that the application of FRND obligations must ensure that the request for access was also reasonable and might not be granted in full, or even at all, if the bus station really was operating at full capacity.219

15.246 We concluded that where a bus station is genuinely close to, or at, capacity, the Manager should, where reasonably practicable, provide layover capacity to avoid stand blocking. This is particularly important where there is direct competition, as it is desirable for competing services to depart from the same (or adjacent) stands. However, we note that in some bus stations, stands are grouped by operator, and this may be justifiable given the specific circumstances of the bus station. We recognize that capacity will vary considerably from one bus station to another and that increased capacity can sometimes be achieved through effective management of the bus station.220 In view of the above, we did not find it practicable to be overly prescriptive in defining generally applicable rules relating to stand capacity and its allocation.

15.247 We found that there was a risk that the Manager could circumvent an FRND access remedy by mismanaging capacity. In its response to the provisional decision on remedies, Rotala told us that there were a number of subjective issues when trying to define bus station capacity for the purpose of stand allocation, and therefore suggested that a ‘more prescriptive approach’ may be required.221

15.248 We decided that the risk of circumvention could be managed by the following provisions:

(a) The Conditions of Use, which should contain information about the Manager’s calculation of capacity and methodology for allocating stands, should be published in a prominent place in the bus station. Relevant stakeholders (including Users and the LTA) should also be invited to comment on the proposed approach.

(b) The Conditions of Use should set out an effective process by which Users can raise disputes over matters such as capacity and stand allocation, including the involvement of an independent expert in the resolution of any disputes (see paragraphs 15.270 to 15.277 below).

216 Nexus response to Remedies Notice, Issues for comment 8, part (c).
217 FirstGroup response to Remedies Notice, Annex 3, comment on part b).
218 Stagecoach response to Remedies Notice, paragraph 3.37, and Stagecoach response to provisional decision on remedies, paragraph 5.41.
220 For example, we quoted in the Worcester case study (see Appendix 6.4, Worcester case study, paragraph 47) a report by independent consultant Halcrow which included examples of bus stations where 8 to 15 departures per hour per stand had been achieved by adopting certain practices.
221 Rotala response to the provisional decision on remedies, paragraph 27.
(c) Our guidance on setting charges on an FRND basis (see Appendix 15.4, Part 3) states that Managers should not recover the costs of capacity used by their own buses from other Users. This would incentivize the Manager to utilize bus station capacity with their own buses efficiently, for example by minimizing their dwell times, and actively encouraging Users to use its bus station.

(d) Our remedy requires Managers to accept access requests for bus stands and layover bays from Users and only refuse access where it is reasonable for them to do so, for example in cases where the bus station is genuinely operating at capacity.

- Access issues: driver facilities

15.249 In paragraph 9.137, access to driver facilities (eg canteens and toilets) at a bus station was raised as a concern by some local authorities in relation to the management of bus stations owned by local bus operators.

15.250 This issue was also raised by Metro in relation to Wakefield bus station (which is owned and managed by Arriva). The problem of access to driver facilities at a bus station was also identified in the Lancaster case study, although in this case the manager of the local bus station was the city council rather than a local bus operator.

15.251 In response to our Remedies Notice, ATCO Scotland told us that equal access to the bus stands for the bus service must be matched by access by drivers to staff facilities (where available) such as a staff room with refreshments and toilets.222

15.252 In its response to the provisional decision on remedies, B&NES welcomed the proposals to secure FRND access to bus stations, including access to driver facilities, as well as layover bays, timetable and marketing facilities.

15.253 Go-Ahead and Stagecoach, in their responses to the provisional decision on remedies, commented on how FRND access to driver facilities for Users should work in practice:

(a) Go-Ahead told us that ‘access rights’ should ‘go no further than reasonable access to operate bus services out of the bus station’ and cited that giving unrestricted access to all parts of a bus station may compromise security, eg in relation to the Manager’s commercially sensitive information stored in certain areas of the bus station.223

(b) Stagecoach told us that third party access should not be granted to:

- facilities such as canteens or paying in areas, which are effectively extensions of the bus operator’s own depot facilities … and could contain sensitive information. Access to such facilities is not essential to a third party’s ability to operate services (and invariably there will be alternative places for drivers to eat or take a break.224

15.254 Our remedy will require Managers to give Users access to driver facilities where such facilities exist, with a description of the available facilities set out in the bus station’s Conditions of Use. This requirement should be on a ‘best endeavours’ basis, recognizing that access may be denied where a Manager has good reasons for doing so.

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222 ATCO Scotland response to Remedies Notice, paragraph 4.
223 Go-Ahead response to provisional decision on remedies, paragraph 4.4.
224 Stagecoach response to provisional decision on remedies, paragraph 5.4.4.


eg where driver facilities are located inside a Manager's own offices adjoining the bus station. We would also expect the consultation process with local stakeholders in relation to the Conditions of Use, to identify to which driver facilities Users should be given access.

- **Access issues: marketing facilities**

15.255 Problems relating to the display of timetables were indentified in the Worcester case study (see Appendix 6.4—Worcester, paragraphs 59 to 64).

15.256 In our Remedies Notice, we asked whether there should be a remedy concerning access to sales and marketing facilities at bus stations. We received the following responses:

(a) ATCO Scotland said that fair access provisions must also include provision of travel information.

(b) Passenger Focus told us that passengers accessing a bus station wanted to be able to find information about fares and journeys, but if there was limited information available then this could prevent the journey from taking place.

(c) ATCO told us that it understood that operators which managed stations would want to promote their own services over their competitors and foresaw that tension might arise.

(d) A small operator, Regal Busways, commented:

   In a lot of privately owned bus stations the dominant operator will have a travel shop, which sells period tickets and also provides information to customers about their own tickets, in a lot of cases small independents like ourselves cannot afford to have these travel shops and therefore there should be some kind of obligation that they offer impartial advice and also allow us to sell tickets through their shops.

15.257 We concluded that information and transparency have important roles to play in delivering competitive outcomes in markets for bus services. Passengers should therefore be given easy access to information about all services, and not only to those which are run by the operator of the bus station. We concluded that Managers must allow access on an FRND basis to timetable displays and other marketing facilities at bus stations to allow Users to publicize their services.

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225 An example of good practice in relation to fair access to multi-operator timetable information at a bus station came from National Express (see its response hearing summary, paragraph 32), in relation to bus stations which are managed by Centro and therefore not Relevant Bus Stations under our remedy. National Express told us that bus information across the West Midlands was coordinated by Centro and that there was a very good range of multi-operator timetables which were available at bus stations. There was no discrimination in the provision of information. Ownership of the sales outlet at bus stations varied, some were owned by Centro and others were rented by National Express, but there was a non-discriminatory policy as a term of the lease to ensure non-discrimination against other operators and it was monitored by Centro.

226 ATCO Scotland response to Remedies Notice, paragraph 4.

227 Passenger Focus response hearing summary, paragraph 18.

228 ATCO response hearing summary, paragraph 33.

229 Regal Busways response to Remedies Notice.
Charges for using a bus station

15.258 In paragraphs 9.147 to 9.157, we found that the level of departure charges could disadvantage other operators compared with the Manager, and could therefore act as a barrier to entry for new operators and expansion for existing operators.

15.259 We received a variety of responses to the Remedies Notice, with some operators emphasizing the need to leave scope for negotiation, differentiated charging and the ability to recover the cost of investment (even where not intended for the bus operators):

(a) FirstGroup argued that an effective scheme should have an adequate mechanism for recovering costs; allow for improvements and investments made to be fully recovered through charges; and allow for higher charges to be levied on local bus operators where they were using a high-specification facility primarily intended for other use and for differential pricing between coach operators and bus operators.230

(b) Go-Ahead told us that the scheme must not be overly prescriptive and must leave scope for negotiation; and would need to reflect the need for the station operator to be incentivized to invest in the bus station facilities and reflect differences in cost per departure between higher-volume users and lower-volume users. It added that an overly prescriptive approach could lead to higher charges.231

(c) By contrast, [Bus Operator A]232 and Regal Busways233 argued that all operators should be charged the same amount.

(d) Stagecoach said that charges should be levied on a reasonable basis reflecting costs and a reasonable return on investment.234

(e) SEStran told us that it would welcome measures to ensure full access at ‘fair costs’.235

(f) Some parties (Fife Council236 and Transdev) suggested that benchmarking of charges would ensure fairness. However, Transdev explained that it could be difficult to distinguish between direct and indirect costs and that there would be scope for arguments over cost allocations.

(g) ATCO told us that it had heard of cases where some small operators had not been able to operate from bus stations due to high charges. It believed that having a code built around general principles of fairness intended to ensure that non-incumbent operators were not unfairly disadvantaged, rather than specific rules, would send out positive messages and be easier to enforce.237

15.260 Given the diversity of local circumstances, we did not find that a single price cap on departure charges across all Relevant Bus Stations would be appropriate. Neither did we expect that the publication of charges, by itself, would be sufficient to prevent high or discriminatory departure charges. In particular, given the different individual

230 FirstGroup response to Remedies Notice, Annex 3, comment on part (b).
231 Go-Ahead response to Remedies Notice, paragraph 4.4.
233 Regal Busways response to Remedies Notice.
234 Stagecoach response to Remedies Notice, paragraph 3.37.
235 SEStran response to Remedies Notice.
236 Fife Council response to Remedies Notice.
237 ATCO response hearing summary, paragraph 31.
circumstances of bus stations, it would be difficult for Users to establish whether a charge was appropriate based on comparing the charge with charges at other bus stations.

15.261 Instead, we decided that our remedy should require Managers to determine FRND charges for each Relevant Bus Station based on our guidelines in Appendix 15.4, Part 3. In addition, Users should have an effective way to dispute departure charges (see paragraphs 15.275 to 15.277 below).

15.262 In obliging Managers to set departure charges that are FRND, we are concerned to ensure that Managers do not deter Users from using bus stations under their management by charging excessive prices. When considering what is an FRND charge:

(a) Our benchmark for a ‘fair and reasonable’ price is the price that reflects any directly attributable costs together with an allocation of the common costs that are necessarily incurred in running the bus station, as well as factoring in a rate of return (see Appendix 15.4, Part 3).

(b) By ‘non-discriminatory’, we mean that the operator should offer access on no less favourable terms to one operator than those under which it provides access to other operators. This means that charges, and any discounts, should be set on objective criteria that are capable of independent verification in the event of a dispute.

15.263 B&NES told us in its response to the provisional decision on remedies that our remedy should also include an FRND charging mechanism for the use of layover bays, stating that ‘there is significant value—and potential competitive advantage—attached to the availability of layover spaces, which may be separate from the departure points’.

15.264 We note that charges to Users for using a bus station may take different forms, eg monthly or annual bay rental charges or charges per departure, and therefore the form of the charge should not circumvent any of the FRND principles set out in our remedy. Our guiding principles on the FRND pricing mechanism (see Appendix 15.4, Part 3) should apply to all charges levied on Users for access to the bus station facilities (including stands and layover bays). We therefore agreed with B&NES that this should include charges for use of layover bays.

15.265 Whilst none of the responses to the provisional decision on remedies disagreed with the principle that charges should be based on the directly attributable costs of a bus station, the majority of responses concerning departure charges focused on our FRND pricing guidelines (Appendix 15.4, Part 3), in particular where Managers were not permitted to recover the cost of unused/excess bus station capacity from Users:

(a) FirstGroup told us that departure charges should enable Managers to recover the cost of unused or excess capacity at the bus station, and argued that a ‘rational, independent owner would set departure charges at a level so as to recover its costs and maximise its return on investment, whether or not this involves 100% capacity utilisation at all times’, and that preventing Managers from doing so would deter Managers from investing in their bus stations to expand capacity.²³⁸

²³⁸ FirstGroup response to provisional decision on remedies, paragraph 5.2.
(b) Stagecoach told us that preventing Managers from recovering the cost of unused capacity has the ‘potential to distort competition and is a clear disincentive to retain and operate bus stations’, and ‘puts the third party at a competitive advantage and discriminates against the owners’, since ‘almost all bus stations have very significant levels of non-utilisation due to the nature of bus operation and capacity use being greatest at peak times’.239

(c) Go-Ahead told us that bus operators which manage bus stations are incentivized to invest in and operate bus stations to promote bus usage. However, if Managers are not rewarded for investing into their bus stations, then these benefits are potentially lost.240

(d) Arriva told us that it was disproportionate that ‘bus stations owners should not be able to spread the cost of ownership and maintenance of bus stations across all users proportionate to their use’.241

(e) CPT told us that the inability of Managers to recover the cost of unused capacity would create a ‘competitive imbalance’ and that ‘all costs that can be fairly allocated to the operation of the bus station, and are not met by a third party such as a council or a shopping centre operator, should be borne by the users in proportion to their use of the facility’.242

(f) Centro told us that disallowing the Manager from profiting from third party access may discourage ‘investing in such facilities or providing them in the first place’.243

(g) CILT told us that there was a ‘danger of “free-riding” to the detriment of those operators that have invested in bus stations’ and that departure charges should allow Managers to recover ‘proportionate contributions to such investment’.244

15.266 We noted first that our remedy allows a Manager to recover from Users its investment costs in relation to investment which directly benefit and relate to local bus services,245 as well as an additional return on capital of around 10 per cent (see Appendix 15.4, Part 3). In these ways, we judge that our remedy provides an adequate incentive for efficient investment.

15.267 We concluded that it was reasonable for Users of a bus station to make a contribution towards the costs of maintaining spare capacity, but further concluded, (as set out in Appendix 15.4, paragraph 48) that only a proportion of excess capacity costs should be recoverable. We recognize that measuring excess capacity would need to be determined locally and that some spare capacity is likely to be efficient, eg during off-peak hours. We set out broad guidelines in relation to how a proportion of excess capacity could be recovered through departure charges in Appendix 15.4, Part 3.

15.268 We decided that in relation to charges, the remedy should also include the following aspects:

(a) a requirement on a Manager to publish all charges and discounts as part of the Conditions of Use;

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239 Stagecoach response to provisional decision on remedies, paragraph 5.4.2.
240 Go-Ahead response to provisional decision on remedies, paragraph 4.6.
241 Arriva response to provisional decision on remedies, paragraph 1.8.2.
242 CPT response to provisional decision on remedies.
243 Centro response to provisional decision on remedies, paragraph 3.2.
244 CILT response to provisional decision on remedies, paragraph 11.
245 Excluding, for example, any investments made by the Manager which relate to coach operations.
(b) a requirement on a Manager to enter into a written contract with each User, which sets out the terms and conditions of use for the bus station including the departure charge; and

(c) an effective mechanism by which a User can dispute a departure charge (see paragraphs 15.275 to 15.277 below).

15.269 We recognize that there will be a variety of circumstances applying to individual bus stations and that it is not possible to be prescriptive about the precise approach to be applied to the setting of local bus departure charges in all cases. Nevertheless, Managers should take account of our guiding principles when setting local bus departure charges (as set out in Appendix 15.4, Part 3).

- **Dispute Resolution Procedures**

15.270 We considered how disputes about access and departure charges should be resolved. The OFT told us that:

any dispute resolution mechanism needs to have some teeth insofar as there ought to be a mechanism for disputes to go to arbitration, paid for [by] the operator that owns the bus station. Such solutions are probably better delivered at a local level. Operators could be required to tell us about cases where an arbitration has taken place within a certain time of the arbitration hearing and decision. From our own limited experience, our assumption is that there will be few such cases ... Accordingly, imposing a separate annual reporting mechanism on operators might be disproportionate. Greater transparency around access terms may be helpful in identifying both best practice and where there might be problems.

15.271 In light of these considerations, we decided that Dispute Resolution Procedures should be published by the Manager as part of the Conditions of Use and should be subject to consultation with stakeholders. These procedures should cover the process for handling and resolving disputes over departure charges and other access issues.

15.272 The procedures for resolving disputes over access and departure charges will follow similar but slightly different steps.

15.273 In relation to disputes over access (ie to stands, layover bays, driver facilities and marketing facilities):

(a) Each step of the procedure should clearly set out the time limits for a dispute resolution, as well as the rights of each party to escalate the dispute in the event that they cannot agree.

(b) In the first instance, we would expect disputes to be resolved between the parties, but with the option to escalate the dispute to an appropriate body in the event that this is not possible. In most cases, the LTA is likely to be the most appropriate body to resolve such disputes. However, in some cases the LTA may not be appropriate, for example if it has a conflict of interest. The Dispute Resolution Procedures therefore should set out a clear description of the role of the LTA (as agreed with the relevant LTA).

(c) Any dispute should be resolved within 50 days from the date a party formally raises the complaint to ensure that the dispute can be resolved before the
56 days’ notice period (for Traffic Commissioners) ends for new service registrations. None of the responses to the provisional decision on remedies commented on the time frame within which a dispute should be resolved.

15.274 Stagecoach provided some examples of potential conflicts of interest where the LTA may not be best placed to conduct an arbitration process, including where the operator of a supported service fails to pay departure charges or breaches the Conditions of Use; and where a dispute is between a Municipal Operator and the Manager. \(^{246}\) We noted these comments but did not agree that these circumstances should automatically disqualify LTAs from arbitrating access disputes. We decided that any concerns about an LTA’s potential conflicts of interest should be resolved between the Manager and the User in the first instance, and if necessary, discussed with the relevant LTA. In those cases where it is agreed that an LTA has a conflict of interest which would effectively disqualify it from arbitrating access disputes, another third party (eg another LTA or an independent expert) should perform this function.

15.275 In relation to disputes over departure charges, the following steps should be taken:

(a) On request, a Manager shall supply a calculation to a User to demonstrate that the departure charge has been set on an FRND basis following the CC’s Guidelines for setting departure charges (see Appendix 15.4, Part 3). This explanation shall include calculations and relevant supporting information.

(b) In the event that the User is not satisfied with the Manager’s explanation, it can request that an independent expert be appointed by the disputing parties to audit and verify the calculation, where the independent expert’s decision on the appropriate departure charge will be final and binding on both parties. To enable disputes to be resolved promptly, we would expect such requests to be made within a short period (eg no more than five working days) of receipt of the Managers’ calculations.

(c) The parties then have a further period to appoint an appropriate independent expert. We did not envisage that the selection of an appropriate independent expert will be problematic and none of the responses to the provisional decision on remedies highlighted this to be a problem. There are, for example, a large number of accounting and audit firms who would be likely to have suitably qualified personnel to undertake this role. To enable disputes to be resolved promptly, we would expect such an appointment to be made within a short period (eg no more than five working days) after any request made by a User.

(d) The independent expert must assess whether or not the Managers’ calculations are FRND. If he/she decides that they are not, then the expert must determine an appropriate charge. The expert may request further information as is necessary from the Manager in order to complete this calculation. The expert’s determination is binding on the parties. We would expect the entire process to take no more than 50 days.

15.276 In their responses to the provisional decision on remedies, both FirstGroup and Stagecoach agreed that an independent expert would be best placed to resolve a dispute if bilateral talks fail, but made suggestions on which party should bear the cost of any independent expert:

\(^{246}\) Stagecoach response to provisional decision on remedies.
(a) FirstGroup told us that the independent expert should determine which party should bear the costs of resolving a complaint, subject to both parties mitigating their costs to the extent reasonably possible. FirstGroup added that it would expect ‘the “winning” party would usually be awarded its reasonable costs. For example, if the final charge is materially lower than that calculated by the manager, the manager should usually bear the costs’ and vice versa.247

(b) Stagecoach told us that ‘the loser should bear the costs or the award of costs should be a matter for the discretion of the arbiter’.248

15.277 We concluded that there needed to be a balance between empowering Users to raise concerns, thereby providing incentives on Managers to set prices at an FRND level, while not encouraging ‘frivolous’ appeals. In our view, a reasonable way to address this balance would be for an independent expert to be jointly appointed by the Manager and the disputing User (or Users) and for half the cost of appointing an independent expert to be borne by the Manager and the other half by the disputing User (or Users). A joint cost-sharing approach would ensure that each party has sufficient control over the scope of work for the independent expert and is sufficiently liable for its associated costs.

- Implementation and monitoring

15.278 We considered the issues of implementation and monitoring together since the two issues are closely linked.

15.279 A number of parties (Arriva, Go-Ahead, NCT, SPT and B&NES Council249) suggested that the LTA was best placed to monitor compliance with FRND rules. Two parties made specific, contradictory points regarding the powers of LTAs:

(a) Arriva noted that LTAs had no rights over privately-owned land. It suggested that the fair access principles should be introduced by primary legislation and that this legislation could empower the LTAs. Arriva suggested that for new bus stations, FRND provisions should be applied as a condition to planning consent.250 Arriva told us that in terms of resolving disputes, in its experience this was often dealt with by the LTA. However, another option would be for the operators using a bus station to enter into a binding agreement and for there to be a formal arbitration process. Arriva was not sure that problems could necessarily be resolved by using the licensing system to ensure that access to bus stations was on FRND terms, particularly if the problem was with the owner of a bus station that was not an operator.251

(b) B&NES Council on the other hand told us that an access agreement between operators for use of facilities was properly a Qualifying Agreement under Schedule 10 of the Transport Act 2000 (as amended), and should be subject to the competition test at Part 2 of Schedule 10. Such an agreement would therefore require certification from the LTA that the agreement was in the interests of passengers using local services. An LTA would therefore be in the best position to arbitrate between operators using the bus station facilities and ensure that fair access obligations were being met. If the LTA could not certify the fair access

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247 FirstGroup response to provisional decision on remedies, paragraph 5.2(b).
248 Stagecoach response to provisional decision on remedies, paragraph 5.45.
249 Response to Remedies Notice: Arriva, Issues for comment d); Go-Ahead, paragraph 4.4; NCT, paragraph 3.7.3; SPT, paragraph 1.2; B&NES, paragraph 48d).
250 Arriva response to Remedies Notice, Issues for comment 8.
251 Arriva response hearing summary, paragraph 23.
obligations, then it was likely that the operator access proposals would fail the 
competition test in section 9 of the 1998 Act, which would be actionable by the 
OFT, and further leave the operators subject to action from the Traffic 
Commissioners.252 B&NES reiterated this point in its response to the provisional 
decision on remedies, stating that the LTA had a statutory responsibility to certify 
Qualifying Agreements.253

15.280 SPT considered that Fair Access Agreement/licences should be submitted and 
approved by the Traffic Commissioner, and that the LTAs should have an opportunity 
to comment. SPT envisaged a significant ongoing monitoring role for the LTAs, 
including:

(a) an obligation on the LTAs to develop model terms and conditions for FRND 
obligations, based on guidance to be issued by the Scottish Government and 
their own access agreements;

(b) the identification by the LTA of bus stations to which FRND obligations should 
apply within a region (or appropriate LTA area). This should be kept under 
regular review and be noted in the LTA’s strategies and made available on its 
website; and

(c) a requirement for the bus station operator to review the terms of the Fair Access 
Agreement every year and to notify the LTA and Traffic Commissioner about the 
terms of the ‘Fair Access Obligations’ every year with no changes to be made 
within 70 days of the notification.254

15.281 By contrast, Go-Ahead and WAWCC suggested that monitoring should be by excep-
tion, based on complaints.

15.282 Others (Fife Council, ALBUM and Nexus255) suggested that Traffic Commissioners 
could have a role in monitoring FRND. The DfT, however, pointed out that there 
would be practical and resource implications of making fair access to bus stations on 
a PSV operator licence, which would require a level of monitoring and enforcement 
by Traffic Commissioners.256 VOSA told us that incorporating fair access obligations 
in operator licences was not practical; would involve placing a standard condition on 
all licences, including (retrospectively) existing licences; would require primary legis-
lation; and if it were to be monitored and enforced, have resource cost and funding 
implications.257

15.283 Only FirstGroup mentioned the OFT as a suitable monitor258 and SPT noted that 
breaches of FRND obligations relating to unfair trading could be referred to the 
OFT.259

15.284 We decided that the remedial action described above will be implemented by the CC 
making an Order using the powers available to it under the 2002 Act. We considered 
whether as an alternative we could recommend legislative change to implement the 
remedy, but we were not satisfied that this approach would achieve as timely a


253 Schedule 10 of the Transport Act 2000 (as amended), Part 2, paragraph 17(4)(a). B&NES response to provisional decision 
on remedies, paragraph 48(d).

254 SPT response to Remedies Notice, paragraphs 6.8 & 9.3.

255 Responses to Remedies Notice: Fife Council, p2; ALBUM, Issues for comment d); Nexus, Issues for comment d) say that 
operator should appeal to Traffic Commissioners or an alternative regulatory body.

256 DfT response to Remedies Notice, paragraph 62.

257 VOSA response to Remedies Notice.

258 FirstGroup response to Remedies Notice, p25, question 48d).

259 SPT response to Remedies Notice, paragraph 6.8.
solution as direct CC action. None of the responses to the provisional decision on remedies commented on our decision to implement the remedy by way of an Order.

15.285 We considered B&NES’s comment above that the bus station’s Conditions of Use and any bilateral contracts between a Manager and a User would be a Qualifying Agreement under the Transport Act 2000, which would give LTAs a statutory obligation to certify that these agreements are in the public interest. We note that the concept of Qualifying Agreements is intended to cover those agreements between bus operators relating to their respective services that would ordinarily reduce competition between them (eg on frequency) but which an LTA considers would be in the public interest. Agreements between Users and a Manager are made in its capacity as facility manager and not as a bus operator in relation to its own operations. We therefore concluded that Conditions of Use are not such agreements.

15.286 The OFT would be responsible for the monitoring of the remedy under section 162 of the 2002 Act. To assist the OFT in its duty to monitor, we decided that Managers should keep a record of all complaints they have received and how they have been resolved for the past two years and submit these to the OFT on request. We also decided that for compliance purposes, the Manager should, at the end of each calendar year, provide the LTA with its record of all complaints for the past 12 months. We expect that LTAs will have an important role to play in resolving disputes in the event that the parties cannot agree. We received generally positive feedback from LTAs on their involvement in the dispute resolution process between the Manager and third parties.

15.287 Disputes at bus stations typically occur following the entry into an area or expansion by a local bus operator and we only expect a small number of complaints to be raised. Therefore it seems unlikely that such reporting requirements would be particularly onerous.

15.288 We conclude that the monitoring role of the OFT, taken together with the Manager’s own Dispute Resolution Procedures, would be an effective compliance process, which we anticipate would act as a deterrent to a breach of the remedy resulting in limited requirement for formal enforcement action under the 2002 Act.

15.289 The OFT (and any other person affected by the breach) could take action to enforce under section 167 of the 2002 Act. However, as mentioned above, the Manager’s Dispute Resolution Procedures will limit the need for persons to take enforcement action under the 2002 Act, ie the Manager’s Dispute Resolution Procedures should encourage issues to be resolved locally by the parties in the first instance, if needed, with some mediation from an appropriate independent expert.

15.290 Any monitoring by the LTA and the OFT should be limited to cases which are escalated to them through the Dispute Resolution Procedures. Further details of the costs of compliance and monitoring are set out in Appendix 15.8.

**Supported services**

**Summary of remedy**

15.291 Figure 15.4 summarizes our remedy in relation to supported services.

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260 As set out in Schedule 2 of the amendments to Schedule 10 to the Transport Act 2000 (as amended), a Qualifying Agreement is an agreement between bus operators only. Source: www.legislation.gov.uk/ukpga/2008/26/schedule/2.

261 Schedule 10 of the Transport Act 2000 (as amended), section 18(3)(a).

262 Schedule 10 of the Transport Act 2000 (as amended), section 18(4)(a).
FIGURE 15.4

Summary of remedy relating to supported services

We have decided to recommend that:

- the Secretary of State for Transport publishes updated best practice guidance on tendering for supported services for use by LTAs in England;

- the Scottish Government develops similar, but suitably tailored, best practice guidance for use by LTAs in Scotland;

- the Welsh Government develops similar, but suitably tailored, best practice guidance for use by LTAs in Wales;

- LTAs in England, Scotland and Wales engage actively in the process of developing and revising this best practice guidance and have regard to this guidance when awarding new tenders;

- the Secretary of State for Transport (in consultation with the Welsh Government) and the Scottish Government give LTAs powers to obtain information about revenue and patronage of deregistered services, and the right to disclose information in such detail as they consider appropriate, having regard to its nature, to potential bidders for subsequent tenders. Failure by an operator to provide this information may result in the request to deregister the service being refused; and

- pending the legislative amendments that we have decided to recommend, LTAs seek to obtain information about newly deregistered services on a voluntary basis and develop, where necessary, information-sharing agreements with local operators to facilitate the transfer of such information. During this interim period we further recommend that the DfT and the Scottish and Welsh Governments work together with LTAs and bus operators to develop a template agreement for the provision of information on deregistered services in line with our recommendation for legislative change.

How this remedy addresses the AEC

15.292 In section 12, we found that competition for the tendering of supported services is restricted by a lack of bidders for some service contracts. In addition, we found that it can sometimes be difficult for LTAs to collect robust information about the likely revenue performance of a service they intend to put out to tender—particularly where this service has previously been operated commercially without support. This means that an incumbent operator can have an advantage when bidding for the contract and/or means that tender prices can be higher if less value is given by other bidders to an uncertain revenue stream.

15.293 The development of up-to-date best practice guidance and the application of this guidance by LTAs in England, Scotland and Wales will reduce the extent to which competition is restricted by aspects of tender design that fall within the control of the tendering authority. The provision of information to LTAs about deregistered services would allow LTAs to provide potential bidders with the information they might reasonably require in order to assess more accurately whether and how to bid, will encourage more operators to bid and therefore realize lower tender prices and (in so far as quality is not set by the terms of the tender) higher quality. This will maximize the
scope for effective competition and reduce the extent of any advantages held by incumbents.

15.294 Moreover, winning a tender has been used by some operators as a way to enter the local commercial bus market. An effective tendering process can therefore be an important means by which LTAs encourage bids from operators which are currently not operating in the area affected by the proposed tender, as a means of stimulating head-to-head or potential competition in the market for local commercial bus services.

15.295 In its response to our provisional decision on remedies, Arriva also suggested that the CC should encourage LTAs to publish automatically the results of tenders as lack of this information may deter aspiring bidders from the next round of bidding.\(^{263}\) We have considered this proposal. While such transparency might be beneficial, we have not found evidence that this aspect of LTA conduct leads to the prevention, restriction or distortion of competition for the tendering of supported services. We also note that there are already regulations which require authorities to publish information about the tender process (see paragraph 13.6).\(^{264}\) We do not, therefore, find that this proposed remedy addresses the AEC we have found and as this is outside the scope of our remedies, we have not pursued this.

**Design issues**

15.296 We considered the design of the following remedy options:

(a) new and enhanced guidance on tendering (see paragraphs 15.297 to 15.301); and

(b) provision of information to LTAs (see paragraphs 15.302 to 15.333).

- New and enhanced guidance on tendering

15.297 While some parties queried whether remedies were necessary at all in relation to tendering for supported services (for example, Arriva\(^ {265}\)) or whether there was an AEC in their area of operations (for example, National Express\(^ {266}\) and NCT\(^ {267}\)), all parties that commented on this proposal supported enhancing existing guidance to LTAs and introducing guidance in those nations where it did not currently exist. Arriva\(^ {268}\) said that the existing guidance in England provided good advice. Stagecoach\(^ {269}\) was concerned that small tenders should not be subject to extensive hurdles or bureaucracy. FirstGroup said that it looked forward to engaging with the DfT and the devolved governments in the development of updated best practice guidance on tendering.\(^ {270}\) ALBUM said that it was essential that operators played a part in developing revised guidelines.\(^ {271}\) One PTE noted that the remedy would not have a significant impact as many LTAs already followed best practice,\(^ {272}\) but that

\(^{263}\) Arriva response to the provisional decision on remedies, paragraphs 5.1 to 5.3.

\(^{264}\) Scottish regulations differ, as described in paragraph 13.7.

\(^{265}\) Arriva response to provisional findings, B6, paragraph 19.

\(^{266}\) National Express response to Remedies Notice, p27, paragraph 2.

\(^{267}\) NCT response to Remedies Notice, paragraph 3.10.1.

\(^{268}\) Arriva response hearing summary, paragraph 35.

\(^{269}\) Stagecoach response to Remedies Notice, p49, paragraph (b).

\(^{270}\) FirstGroup response to provisional decision on remedies, paragraph 6.1.

\(^{271}\) ALBUM response to provisional decision on remedies, p6.

\(^{272}\) SYPTPE, response to provisional decision on remedies.
any guidance should be flexible enough to allow LTAs to determine procurement strategies that met the requirements of their areas.\textsuperscript{273}

15.298 We also received some specific comments in relation to England, Scotland and Wales:

(a) In relation to England, the DfT welcomed our provisional finding on tendering for supported services and said that if the CC’s investigation established that the guidance required updating, it would take steps to do so.\textsuperscript{274} The DfT also told us that this would best be achieved in conjunction with those local authorities that had healthy tender markets due to the creative way in which they packaged their contracts.\textsuperscript{275} ATCO told us that LTAs would be well placed to provide case studies of good practice in any review of guidance and said that it would be happy to support and facilitate such a process. All LTAs in England that expressed a view were supportive of this proposal.\textsuperscript{276}

(b) The Scottish Government told us that there was currently guidance on procurement but some of the stakeholders had concerns about it, and the Scottish Government was considering holding discussions with them and other interested parties, such as ATCO, about possible improvements, which would include looking at the English guidance and what was seen as best practice.\textsuperscript{277} We also received submissions from several LTAs and representative bodies in support of the development of specific guidance in Scotland.\textsuperscript{278} SEStran noted that a good outcome from any development of guidance could be the development of template tender documentation that could be used throughout Scotland.

(c) The Welsh Government said that procurement rules were the same for England and Wales. Many local authorities in Wales shared best practice regarding how they tendered for local services and the Welsh Government also told us that its Bus Working Group\textsuperscript{279} played an important role in disseminating good practice in Wales and that, as a result, there was already quite a high degree of similarity between tender documents issued by LTAs in Wales.\textsuperscript{280}

15.299 We concluded that there was broad-based support for updating and enhancing the guidance already in place in England, and for developing new guidance for Scotland and Wales. We also concluded that it was important for LTAs, operators and other stakeholders to be involved in developing this guidance\textsuperscript{281} to maximize the impact of this exercise by raising the profile of the guidance, and to ensure that the guidance reflected lessons learned from experience in particular parts of the country.

\textsuperscript{273} SYPT response to provisional decision on remedies, paragraph 4.2. Centro also stated that it should be open to tendering authorities to ‘select and apply those [options] which are most appropriate to their own particular circumstances’, response to provisional decision on remedies, paragraph 4.2.
\textsuperscript{274} DfT response to Remedies Notice, section 3.4, p16.
\textsuperscript{275} DfT response hearing summary, paragraph 48.
\textsuperscript{276} Metro response hearing summary, paragraph 26; Cornwall Council response hearing summary, paragraph 41; PTEG response to Remedies Notice, paragraph 10.1; Centro response to Remedies Notice, pp3 & 11.
\textsuperscript{277} Scottish Government response hearing summary, paragraph 29.
\textsuperscript{278} ATCO Scotland response to Remedies Notice, paragraph 5, p2; SPT response to Remedies Notice, p25, response to Q72(b); SEStran response to Remedies Notice, p5; Aberdeenshire Council response to Remedies Notice, p2; collective response from the seven statutory Regional Transport Partnerships in Scotland, letter 3 June 2011, p1.
\textsuperscript{279} The Bus Working Group was established in 2007 to help the Welsh Government to consider and develop policy proposals that appeared in the 2008 Act. Since then, the Bus Working Group has assisted the Welsh Government in delivering the new three-year deal for concessionary fares in Wales as well as a review of BSOG and the Local Transport Services Grant (LTSG)—which is ongoing and will help the Welsh Government consider any legislative changes that are needed in response to the CC’s findings and recommendations. The Bus Working Group has members from the bus industry (including SME operators); local authorities; community transport association and passenger representation.
\textsuperscript{280} Welsh Government response hearing summary, paragraphs 25–27.
\textsuperscript{281} Coordination of LTA input might be achieved through a forum such as ATCO, or the Bus Working Group in Wales. The DfT also noted that the LGA could play a role in disseminating best practice guidance across local authorities (DfT response to provisional decision on remedies, paragraph 61).
15.300 We considered the main priorities, from the perspective of enhancing competition, for any new or revised guidance. In doing so, we drew on our analysis of tendering for supported services in Section 13, the responses we received to our Remedies Notice, the evidence gathered in response hearings and responses to our provisional decision on remedies. We concluded that the following issues were particularly worthy of attention in any new or revised guidance:

(a) the actions that LTAs can take in developing and retaining a competitive market for supported services and, as a consequence, for local bus services;

(b) the specification of contracts to maximize the opportunity for effective competition, drawing on the findings of this investigation;

(c) the interaction between tendering practice and EU procurement rules, to provide LTAs with clarity over which processes are likely to apply; how these processes may be applied to simplify, or add flexibility to bidding; and the assessment of bids to pursue best value; and

(d) deregistered services and the options available to LTAs when a commercial service is registered (or re-registered) over the same route as a supported service.

15.301 We set out our views on each of these issues in Appendix 15.5.

- Information remedy

15.302 All LTAs that expressed a view were supportive of this remedy. Overall, operators were content, in principle, to provide information to LTAs about supported and deregistered services but made a number of different comments on the detail of the remedy, which we address as part of our consideration of the design of this remedy. Among the Large Operators, for example:

(a) Arriva told us that it would not have any significant concerns with providing details of passenger and revenue figures to the LTA for a route being deregistered and then put out to tender and that in some areas it already provided revenue data when it operated a tender which came up for re-tender.\(^{282}\)

(b) FirstGroup thought a requirement for the deregistering operator to provide the LTA with data could present problems, but that it might be possible to provide information about passenger flows.\(^{283}\)

(c) Go-Ahead told us that it had no objections with patronage information from a route which had been deregistered being provided to the local authority and to potential bidders, but it did not support the provision of other information such as costs and revenues, as this might reveal sensitive information about its other commercial services in that area. There would only be a negligible administrative cost in providing patronage information.\(^{284}\)

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\(^{282}\) Response hearing summary, paragraph 36.

\(^{283}\) Response hearing summary, paragraph 44.

\(^{284}\) Response hearing summary, paragraph 30.
(d) National Express told us that its only concern with a remedy to share commercial information with the LTA was how far this would then become available to other operators.\textsuperscript{285}

(e) Stagecoach told us that it had no objections to a requirement for tendering authorities to collect information from operators following tenders, but it recognized that local authorities did not always receive accurate information from some operators.\textsuperscript{286}

15.303 Several small and medium-sized operators expressed support for this remedy.\textsuperscript{287} For example, Bluebird Bus and Coach said that the tendering process could be improved if all bidders were given information about both revenue and passenger numbers.

15.304 We received consistent evidence from both LTAs and operators that LTAs had the necessary powers to require the provision of sufficient information about the performance of supported services as part of their contract specification. We therefore concluded that there was no need for a specific remedy to require the provision of information in relation to an existing supported service. However, the best practice guidance could usefully address what information to request as part of contract specification (see paragraphs 15.297 to 15.301).

15.305 In relation to the provision of information on newly deregistered services, it was much less clear that LTAs currently have sufficient powers to require the submission of adequate information (see paragraphs 15.325 to 15.333).

15.306 We considered the following issues about the design of any obligation to provide information to LTAs about deregistered services:

(a) What information should be provided to LTAs and when?

(b) What restrictions, if any, should be placed on LTAs' subsequent use of the information provided to them?

(c) The extent of current LTA powers to secure information about deregistered services and whether these powers are sufficient.

\hspace{1em} What information should be provided to LTAs and when

15.307 We asked LTAs what information they would find useful when specifying tenders. There was support for the provision of both revenue and patronage information.\textsuperscript{288} Cornwall Council\textsuperscript{289} also referred to information on where passengers boarded services, and it and SYPTE\textsuperscript{290} referred to patronage by ticket type. TfGM\textsuperscript{291} referred to service performance information. However, Centro\textsuperscript{292} said that it only supplied passenger numbers to bidders when tendering as it considered that fare policies, use of off-bus ticketing and concessionary passengers could all vary between operators when a service was tendered.

\hspace{1em} Response hearing summary, paragraph 35.
\hspace{1em} Response hearing summary, paragraph 36.
\hspace{1em} Rotala response hearing summary, paragraph 22, and response to provisional decision on remedies, paragraph 28; ALBUM response to Remedies Notice, paragraph 72d).
\hspace{1em} SPT response to Remedies Notice, Q72d); Aberdeenshire Council response to Remedies Notice, pp1 & 2.
\hspace{1em} Cornwall Council response hearing summary, paragraph 39.
\hspace{1em} SYPTE response to Remedies Notice, p15.
\hspace{1em} TfGM response to Remedies Notice, p6.
\hspace{1em} Centro response to Remedies Notice, p10.
We asked operators what information was most likely to be useful when bidding for services. We received the following views:

(a) Arriva told us that the principle of providing anonymized revenue information to an LTA if a commercial service was deregistered was welcome in principle.\(^{293}\)

(b) FirstGroup said that, when bidding for a route, it would want to receive information about passenger numbers, but it would also physically observe the route to gain information about passenger flows and how many passengers were buying full-fare tickets or using concessionary ones.\(^{294}\)

(c) Stagecoach responded that when bidding for a tender it did not already operate, the most important information for Stagecoach to have was the service’s revenue level.\(^{295}\)

(d) Lothian Buses\(^{296}\) was sympathetic in principle to requiring operators deregistering a commercial service to provide revenue and passenger information to LTAs, as was NCT.\(^{297}\) Bluebird Bus and Coach stated that passenger numbers alone were not helpful as operators would not know whether they were concessionary fares or full-paying passengers.

B&NES Council\(^{298}\) said that, where possible, at least one year’s data should be provided, broken down by week. FirstGroup\(^{299}\) said that operators should only be obliged to provide information on passenger journey numbers for the period of time required under the tender. Where the routes were part-tendered, the obligation should only extend to the part of the route that was tendered. Subsequent to our provisional decision on this remedy, FirstGroup said that revenue and patronage data must be sufficiently aggregated and should only relate to that portion of the route that is deregistered, to avoid giving competitors an insight into its commercial operators.\(^{300}\) Other LTAs and operators did not express a view on the time period that should be covered.

Some operators raised issues around the practicability of providing different classes of information and the quality of information that was sometimes provided:

(a) Arriva\(^{301}\) noted that it was inevitable that certain data may not be available in all circumstances, as not all operators recorded it, and that, even when provided, data would not be completely accurate as route revenue calculation was dependent upon apportionment of centrally received funds such as concessionary fare income or off-bus revenue. It said that the cost of implementing accounting systems that recorded route revenue data might deter some smaller operators.\(^{302}\)

(b) Stagecoach recognized that local authorities did not always receive accurate information from some operators.\(^{303}\)
(c) Metro noted that some operators did not appear able to provide this information in a timely manner.304

15.311 Some LTAs also queried the quality of the information to be provided, its format and the level of detail. Cheshire West and Chester Council suggested that operators be required to produce an audit trail of the data applying to both commercial services and those with financial support.305 TfGM said that a universal specification for the structure of data would need to be adopted and that disaggregated data for each bus trip (including boarding point and ticket type) would be required for planning purposes. It also said that operators would need to be held accountable for the accuracy and timeliness of the data supplied as this could affect the financial performance of a tendered service, and that provision of timely and accurate data should be a condition when that service was first registered.306 Centro queried whether small operators would be able to provide the information in the detail required.307 We noted these comments and agreed that LTAs should be entitled to expect that the information is as accurate as possible and provided on a timely basis.

15.312 Merseytravel308 said that the introduction of smartcard ticketing with real time information would allow it to access this information more easily. Metro309 said that operators should be mandated to provide the information within a given time frame.

15.313 Some operators told us that, while information about, for example, patronage or revenue on a route was useful, it would not necessarily give a complete account of how the service operated and needed to be considered in context. For example, Lothian Buses310 noted that information based on existing passenger and revenue information may be misleading if, for example, some journeys on a deregistered service could be transferred to other routes. NCT311 also expressed concern that deregistration of a service may be accompanied by other service changes, such as enhancement of frequency on an alternative route or key corridor, which would render past information less relevant. SPT said that the patronage and income from a supported service may not reach that of the previous commercial operation and therefore LTAs must ensure they do not accept liability if this is the case.312 We noted these points and the importance to LTAs of taking into account the context of any information provided to it. However, we did not find that this was a strong reason for such information not to be provided to LTAs; rather it suggested that, when providing such information, it would be helpful for operators also to provide any relevant contextual information to which the LTA should have regard.

15.314 Based on the evidence set out in paragraphs 15.307 to 15.313, we concluded that the following information about deregistered services should be disclosed to LTAs:

(a) Information about the number of passengers who have used the deregistered service. In so far as is practicable, patronage information should include information about the composition of the passenger base on the route (ie proportion of full fare single/return tickets; children; concessionary fares, season ticket holders).

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304 Metro response hearing summary, paragraph 28.
305 Cheshire West and Chester Council response to the provisional decision on remedies.
306 TfGM response to provisional decision on remedies, p17.
307 Centro response to provisional decision on remedies, paragraph 4.4.
308 Merseytravel response hearing summary, paragraph 24.
309 Metro response hearing summary, paragraph 28.
310 Lothian Buses response hearing summary, paragraph 26.
311 NCT response hearing summary, paragraph 36.
312 SPT response to provisional decision on remedies, paragraph 5.5.
(b) Information about the revenue earned on the deregistered service. The provision of revenue figures will have benefits for LTAs and operators alike. It will enable LTAs to consider the likely cost and appropriate specification of any tender. It would also be relevant to potential bidders for tenders to run supported services, particularly in enabling them to price a minimum-subsidy contract.

(c) In relation to patronage and revenue information, data should be provided for each of the 12 months prior to deregistration in order to reflect seasonal variation in patronage over the course of the year.

15.315 As to when the information should be provided to the LTA, we decided that LTAs should have access to the data as soon as was practicable. This would enable LTAs to factor this information into their considerations as to how, if at all, to respond to the deregistration and to feed into any subsequent invitation to tender. We concluded that the information set out in paragraph 15.314 should be provided to the LTA within the 14 days prior to deregistration that we are recommending be introduced as part of the operator behaviour remedy (see Figure 15.2 in paragraph 15.110). To ensure that operators comply with this obligation, we further concluded that non-provision of satisfactory information to the LTA should be a ground for refusing to accept the proposed deregistration. This may necessitate consequential changes to Traffic Commissioners’ powers and/or duties.

15.316 Some parties queried how ‘deregistration’ should be defined in relation to any such obligation. Arriva said that it should be made clear that ‘deregistered’ meant the cancellation of services rather than a reduction of frequency.313 SPT asked that the requirement for disclosure of information applies to both deregistrations and to withdrawn journeys or parts therefore including timetable or routing variations.314 Stagecoach expressed concerns that providing information for all deregistrations was disproportionate as many instances of service deregistration took place for operational reasons, for example it might be replaced with a slightly different or enhanced service, and in those circumstances it was unlikely that the deregistered services would ever subsequently be provided as supported services by the LTA. Stagecoach thought that the onus should be on the LTA to request the necessary information, when considering securing the deregistered service, rather than the obligation being related to all deregistrations.315

15.317 We decided that the obligation to provide LTAs with information about deregistered services should apply to any situation in which a reduction in the provision of commercial services might reasonably be expected to give rise to a tender for supported services. We would expect this to be the case where a service is withdrawn in its entirety, but also to a situation where a service no longer serves particular stops, or no longer stops at particular times of the day or week (eg a withdrawal of evening and/or weekend services). We judged it unlikely that a requirement to issue a new tender would arise from service enhancements or minor changes to service timing or frequency and hence would not expect such changes to constitute ‘deregistered’ services for the purpose of this remedy.

15.318 Stagecoach also stated that this remedy should not be applied in cases where an LTA owns a municipal operator, as this might facilitate leaks to a competitor, but that municipal operators must comply in providing the same information as other bus operators.316 We did not accept this submission. Preventing LTAs in areas with a

313 Arriva response to provisional decision on remedies, paragraph 5.4.
314 SPT response to provisional decision on remedies, p3.
315 Stagecoach response to provisional decision on remedies, paragraphs 6.4 & 6.5.
316 Stagecoach response to provisional decision on remedies, paragraph 6.8.
municipal operator from accessing this information would result in this remedy being ineffective for those areas, and it was unlikely to be practicable to restrict the use of this remedy in this way. We noted that municipal operators are run by separate arm’s length companies, and expect that LTAs would take seriously their responsibilities in relation to the provision of commercially sensitive information.

- Subsequent use of information provided to LTAs

15.319 Some operators expressed concern about the commercial confidentiality of this information and the implications of providing it to competitors.317

(a) FirstGroup318 said that dissemination of information to third parties could have a number of unintended consequences: the provision of recent, disaggregated confidential information would self-evidently fail the usual test applied for the exchange of confidential information between competitors and an LTA would unwittingly find itself therefore the instigator of anticompetitive effects. FirstGroup also said that LTAs must be made subject to a statutory duty to use the information they receive only for the purpose of creating a level playing field for those participating in a tender, and not for any other purpose such as the development of quality contract schemes. It also noted that there were no controls on the LTAs for the subsequent use and disclosure of this information.319

(b) Go-Ahead320 said that the protection of the commercially sensitive information of the incumbent would need to be a paramount consideration in order to prevent distortions of competition. Granting a competitor access to potentially sensitive cost and revenue information could increase transparency in the market generally, and potentially disadvantage the incumbent in any bidding process. Particular sensitivity would arise around the provision of information by an incumbent on a commercial route, as this could give an indication to the incumbent’s competitors of sensitive data relating to its operations of commercial services (for example, including route profitability thresholds). It said321 that while it had no objection to patronage information on deregistered services being provided, other information such as costs and revenues could reveal sensitive information about its other commercial services in the area.

(c) Stagecoach322 said that it did not have any particular concerns regarding dissemination of revenue figures to potential bidders upon a re-tender. If an LTA had required any operator-specific information other than revenue received, any onward disclosure should be carefully assessed. LTAs should only be entitled to disclose the information to those interested in tendering for a contract if the contract being let is one where the operator takes the revenue risk, as otherwise there are no grounds why it should be disclosed to bidders.323

(d) Lothian Buses324 said that where only part of the route or only some periods of operation were being deregistered, there was concern that release of this data might reveal sensitive information relevant to operation of the commercial service.

317 See, for example, National Express response hearing summary, paragraph 35.
318 FirstGroup response to Remedies Notice, paragraph 72d.
319 FirstGroup response to provisional decision on remedies, paragraphs 6.3 & 7.1.
320 Go-Ahead response to Remedies Notice, paragraph 6.4.
321 Go-Ahead response hearing summary, paragraph 30.
322 Stagecoach response to Remedies Notice, p49.
323 Stagecoach response to provisional decision on remedies, paragraph 6.6.
324 Lothian Buses response hearing summary, paragraph 26.
Arriva\textsuperscript{325} said that the information could be disseminated across bidders on a confidential basis and if this induced a rival to operate the service commercially then this was a benefit to the public purse.

15.320 Some LTAs argued that when a commercial operator chose to deregister a service it had given up its commercial interest in that service (eg SEStran\textsuperscript{326}), and therefore there was not a case for commercial confidentiality of patronage and revenue data. Likewise, B&NES Council\textsuperscript{327} said that it did not regard this information as having a particularly high degree of commercial sensitivity. Its experience was that this information had often been provided voluntarily by operators without restriction on its use. It said that it was wholly unlikely that patronage and revenue data from a single route or service could shed much light on the operator’s remaining commercial interests. It also argued that provision of such information could be in the direct interests of the operator as there would be benefits to it in securing a managed transition to a tendered operation, not least in the public relations benefits that accrued from this process.\textsuperscript{328} Passenger Focus\textsuperscript{329} said that a publicly accountable body spending public money should have access to the information it needed in order to be able to provide the best possible service. The Scottish Government, however, expressed concern about sharing commercially sensitive information.

15.321 We considered these submissions carefully. We did not consider that monthly information relating to patronage would be sensitive, especially as all operators told us that the market was transparent. We therefore saw no reason why such patronage information should not be provided to LTAs and, if the LTA so chose, incorporated into information disclosed to potential bidders for subsequent supported service contracts.

15.322 We acknowledged that revenue information has the potential to be more commercially sensitive, particularly if disclosure of this information would provide competitors with insight into the performance of an operator’s remaining commercial services or could be used to facilitate coordination. However, we also noted that the information provided to LTAs about deregistered services would no longer relate to ongoing or future commercial services and the provision of revenue information was required to make this remedy effective in addressing this element of the AEC. Absent the provision of this information, the operator that had deregistered the service would have an incumbency advantage over other potential bidders, which could distort competition for the tender. We took the view that disclosure of annual, rather than monthly, revenue information to potential bidders would strike an appropriate balance between enabling LTAs to run a competitive tender process on the one hand and safeguarding confidential information and preventing coordination on the other.

15.323 We concluded that LTAs should be entitled to incorporate monthly information about patronage and annual information about the revenue performance of newly deregistered services into information disclosed to potential bidders for subsequent tenders on the deregistered route. We agreed with FirstGroup that information provided in this way should only be disclosed for the purposes of facilitating competition for tenders to run supported services. Likewise, we agreed with Stagecoach that where an LTA has decided to take all of the revenue risk on a contract, there would be no practical benefit in disclosing this information to potential bidders.

\textsuperscript{325} Arriva response to Remedies Notice, p48.
\textsuperscript{326} SEStran response hearing summary, paragraph 28.
\textsuperscript{327} B&NES response to Remedies Notice, p8.
\textsuperscript{328} B&NES response to Remedies Notice, paragraph 72d, p8.
\textsuperscript{329} Passenger Focus response to Remedies Notice, p9.
15.324 We further concluded that operators should have the opportunity to submit evidence to LTAs that disclosure of revenue information on a deregistered service would damage their commercial interests. LTAs should be under an obligation to consider such evidence before making any further disclosure. In our provisional decision on remedies, we asked for submissions as to the specific circumstances, if any, in which restrictions on an LTA's ability to disclose revenue information would be justified. Go-Ahead said that it still had some concerns about disclosing revenue information to potential bidders on an annual basis, but welcomed the opportunity for operators to submit evidence to an LTA that disclosure would damage its interests. No other parties made any other specific comments on this aspect of the remedy. The shortage of specific comments on this subject suggested to us that there are unlikely to be many circumstances in which disclosure of such information would damage an operator's commercial interests. In the event that an operator submitted evidence on this matter, the final decision would rest with the LTA and this process should be completed within the 14-day pre-notification period.

- *Extent of current powers of LTAs to secure information about newly deregistered services*

15.325 We considered whether LTAs already had sufficient power to secure the information about deregistered services specified in paragraph 15.314 and, as appropriate, disclose this information to potential bidders for subsequent tenders.

15.326 Several LTAs told us that they did not currently have sufficient powers to seek information about deregistered services. PTEG\(^{331}\) and Cornwall Council\(^{332}\) only referred to information-gathering powers as relating to concessionary reimbursement, and SYPTE\(^{333}\) told us that its powers to obtain information were limited. Cornwall Council told us that it did not receive any information from operators on deregistered services.\(^{334}\)

15.327 Some operators and LTAs told us that information about deregistered services was shared with LTAs on an informal basis in parts of the country.\(^{335}\) National Express told us that it had a data-sharing arrangement with Centro (as part of one of the BSOG incentives) which set out the information to be exchanged with Centro, including revenue information on services, but that Centro was not allowed to share that information with other operators.\(^{336}\) Some PTEs also noted that they already received information about deregistered services.\(^{337}\)

15.328 ALBUM told us that LTAs in England and Wales already had powers to request information about commercial and supported services under *section 143* of the *Transport Act 2000*.\(^{338}\) We noted that LTAs in Scotland had similar powers to request information under *section 43* of the *Transport (Scotland) Act 2001*, and we noted that section 43(5)(f)(i) of the *Transport (Scotland) Act 2001* explicitly permits disclosure of information in relation to deregistered services.\(^{339}\)

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330 Go-Ahead response to provisional decision on remedies, paragraph 5.3.
331 PTEG response to Remedies Notice, paragraph 11.9.
332 Cornwall Council response hearing summary, paragraph 38.
333 SYPTE response to Remedies Notice, p18.
334 Cornwall Council response hearing summary, paragraph 38.
335 SEStran response hearing summary, paragraph 28; Metro response hearing summary, paragraph 28; City of York Council response to Remedies Notice, p11, comment 11d).
336 Response hearing summary, paragraph 35.
337 Responses to provisional decision on remedies: Centro, paragraph 4.4; Metro.
338 Response to Remedies Notice, p21, re 72d.
We considered whether these powers would be sufficient to enable LTAs to request information about deregistered services.

In relation to England and Wales, section 143 of the Transport Act 2000 provides LTAs with the ability to request information about services currently operated, relating to total number of passenger journeys operated, fare structures for those journeys and total distance covered in operating those journeys. We found that LTAs did not necessarily have the power to obtain revenue information, or to disclose this information to potential bidders for future tenders. We also noted that it was somewhat unclear on the face of the legislation as to whether these powers could be used to collect information about newly deregistered, as opposed to current, services. We therefore concluded that, while these provisions enable LTAs to request certain information about services currently operated, it would not necessarily enable them to request revenue information. Nor would LTAs be able to disclose this information to potential bidders for future tenders.

In relation to Scotland, we took the view that section 43 of the of the Transport (Scotland) Act 2001 largely mirrors the applicable legislation in England and Wales. LTAs can request certain information about services currently operated. However, they would not necessarily be able to request revenue information or to use the information thus collected as part of information provided to potential bidders for future tenders.

While we noted that some LTAs had information-sharing agreements with operators that enabled them to obtain information about deregistered services, others did not, and there was no general provision in England, Scotland or Wales that would empower LTAs to secure and, as necessary, disclose such information in future tenders.

We concluded that existing information-gathering powers are unlikely to be sufficient for LTAs in England, Scotland or Wales to secure the information about deregistered services specified in paragraph 15.314 and, as appropriate, disclose this information to potential bidders for subsequent tenders.

**Implementation of remedy**

We considered how this remedy should be implemented.

In relation to the development and enhancement of guidance, we decided that the remedy should take the form of recommendations that:

(a) the DfT updates its best practice guidance on tendering for supported services for use by LTAs in England to take account of developments since the guidance was last issued and the findings of this investigation;

(b) the Scottish Government develops suitably tailored guidance for use by LTAs in Scotland;

(c) the Welsh Government develops suitably tailored guidance for use by LTAs in Wales; and

(d) LTAs in England, Scotland and Wales engage actively in the process of developing and revising guidance and have regard to this guidance when awarding new tenders.
15.336 In relation to the informational remedy, we noted that LTAs already have some information-gathering powers under existing transport legislation (see paragraph 15.328). Given this, we took the view that it would be more practicable to make recommendations to the Secretary of State for Transport (in consultation with the Welsh Government) and the Scottish Government to extend these powers, rather than to introduce new powers ourselves by means of an Order.

15.337 In response to the provisional decision on remedies, the DfT told us that primary legislation would be required both to give LTAs the powers to obtain information from operators and to disclose that information to potential bidders, and to enable Traffic Commissioners to refuse the deregistration if such information was not disclosed. It therefore asked us to consider whether the CC’s Order-making powers might provide a short-term method to compel operators to disclose such information. Having considered the DfT’s comments carefully, we decided that implementation by means of recommendation was a preferable option. This was partly to ensure that a consistent approach was taken in transport legislation to LTAs’ information-gathering powers, but also to ensure that the implementation of this remedy secured the necessary balance between LTAs’ powers to obtain information and their obligations to treat such information carefully. In our judgement, this balance could be better struck by means of legislation or agreement between LTAs and operators (see paragraph 15.339) than by a CC Order, which by its nature can only bind operators.

15.338 We therefore decided to recommend to the Secretary of State for Transport (in consultation with the Welsh Government) and to the Scottish Government to extend existing information-gathering powers to enable LTAs to obtain information about revenue and patronage of deregistered services (as specified in paragraph 15.314). LTAs should be able to disclose this information as they consider appropriate to potential bidders for subsequent tenders for the purposes of facilitating competition for tenders to run supported services. This information should be provided to the LTA within the 14-day pre-notification period, recommended in Figure 15.2 in paragraph 15.110, and failure by an operator to do so may result in the request to deregister the service being refused. The legislation should ensure that LTAs are entitled to expect that this information is as accurate as possible.

15.339 As the extension of LTA powers will require additional legislation, we further recommend to LTAs that, pending any legislative change, they seek to obtain information about deregistered services on a voluntary basis and develop, where necessary, information-sharing agreements with local operators to facilitate the transfer of such information. In response to the provisional decision on remedies, PTEG suggested that this interim recommendation should also be directed to operators (who owned the data) and the DfT (which could issue relevant guidance) rather than to LTAs. We agreed with this submission and also noted that, as suggested by SPT, experiences of such voluntary arrangements may also help to inform the drafting of workable legislation and that guidance on these interim arrangements could usefully be produced to assist LTAs and operators. To maximize the opportunities for effective voluntary arrangements to be reached as an interim solution, we recommend that as part of the process of updating the guidance on tendering for supported services, the DfT and the Scottish and Welsh Governments work together with LTAs and bus operators to develop a template agreement for the provision of information on deregistered services in line with our recommendation for legislative change.

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340 DfT response to provisional decision on remedies, paragraph 64.
341 PTEG response to provisional decision on remedies, paragraph 9.2.
342 SPT suggested that a ‘pilot’ could provide useful experience: response to provisional decision on remedies, paragraph 5.7.
Competition enforcement and compliance

Summary of remedy

15.340 Figure 15.5 summarizes our remedy in relation to competition enforcement and compliance.

FIGURE 15.5

Summary of remedy on competition enforcement and compliance

Effective competition enforcement will maximize the impact of our remedy package in addressing the AEC and will prevent our remedies from being undermined by anti-competitive mergers or by operator behaviour in the form of illegal coordination or exclusionary conduct. It is equally important that local bus operators foster a culture in which compliance with competition, as with every other, law is not seen as a technicality. To ensure that this is the case, we have decided to recommend that:

- the OFT continues to apply a high priority to identifying bus mergers between competing operators, making full use of bus-market-specific sources such as the specialist trade press;

- the OFT routinely follows up bus mergers where it expects to have jurisdiction and takes a cautious approach in exercising its discretion not to refer mergers to the CC on de minimis grounds. We recommend that the OFT reviews the application to bus mergers of its guidance on exceptions to the duty to refer. In any such review, we would recommend that the OFT considers the case for indicating a lower market size threshold than £3 million, below which it is likely to exercise its discretion not to refer bus mergers; and

- the OFT revises its frequently asked questions (FAQs) about the application of competition law to the bus industry, taking into account relevant developments since that document was last published.

We also expect, following publication of this report, that local bus operators will review their competition compliance training, making use of the guidance available to them, and impress upon their employees that real competition compliance is an important part of the culture of their organization.

How this remedy addresses the AEC

15.341 The effective enforcement of competition law will have an important role to play in supporting the measures set out in paragraphs 15.11 to 15.339. Effective competition enforcement—and a commitment to compliance with competition law by bus operators—will maximize the impact of our remedy package in addressing the AEC and will prevent our remedies from being undermined by operator behaviour in the form of illegal coordination or exclusionary conduct such as predation. We have found a high level of concentration in local bus markets to be a feature that, in combination with other features, contributes to the AEC that we have found. Effective merger control will prevent further increases in market concentration that lead to an SLC. While we are not recommending fundamental changes to the application of competition law, we set out below the role that we see for competition enforcement alongside our other remedies and make some recommendations for the future.
Design issues

15.342 In considering the design of this element of the remedy package, we first make some general observations about the application of UK competition law to the bus industry, before we consider each of the main elements of UK competition law.

- General considerations

15.343 The main elements of UK competition law applicable to the bus industry are summarized in paragraphs 12.63 to 12.68. These are the Chapter I and Chapter II Prohibitions of the 1998 Act, which prohibit anticompetitive agreements and abuse of a dominant position respectively, and the 2002 Act which allows for scrutiny of mergers. In addition, the 2002 Act allows for the OFT to carry out market studies and to make a reference to the CC to conduct an in-depth market investigation such as this one. The framework for competition policy is currently under review by the Department for Business, Innovation and Skills. Responsibility for the enforcement of the Chapter I and Chapter II prohibitions rests principally with the OFT. The merger and market jurisdictions are the shared responsibility of the CC and the OFT. However, the obligation to observe the competition laws and to operate within them is a matter for the operators themselves.

15.344 Some characteristics of bus markets pose practical and policy challenges for the effective enforcement of competition law. As we have found in this investigation, competition takes place at a local level, and as a result the specific actions or transactions of interest will tend also to be localized and the value of the routes directly affected may be small. This can mean that individual cases might sometimes appear not to be worth pursuing through competition law enforcement. However, in the context of this particular industry, operators that might be perceived as small, when considered on a national scale, may nevertheless have a significant competitive impact in the local markets in which they operate. Moreover, the cumulative effect of anti-competitive conduct and/or a number of individually small mergers can be substantial, both within individual bus markets and sometimes more widely.

15.345 In our view, it will be important in the future for competition authorities to take full account of these characteristics and of the findings of our investigation when taking decisions relating to specific local bus markets, and to consider any broader impacts, including deterrent effects, of their actions. To this end, competition authorities should also take all necessary steps to ensure that competition law is well understood by operators. This approach is likely to maximize the deterrent effect of competition policy interventions.

15.346 As to the obligation on operators to carry on business within the competition laws, Stagecoach put forward a suggestion that the OFT might update its FAQs about the application of competition law to the bus industry, with particular regard to dominance issues and pricing benchmarks. This document was last updated in 2006.

15.347 We discussed this with the OFT, which told us that it had received a complaint from the Campaign for Better Transport, backed up by a legal opinion, that this document was too prescriptive and was restricting beneficial arrangements between bus oper-
ators. The OFT subsequently put some initial resources into updating the FAQs but this work was superseded by developing joint bus guidance with the DfT, following the 2008 Act.\footnote{346}

15.348 We took the view that the joint bus guidance with the DfT was a useful document, particularly as it relates to the treatment of competition matters under transport legislation. However, we considered that the focus of the joint bus guidance was rather different from the FAQs and that an updated version of the FAQs, aimed specifically at bus operators and with a greater emphasis on generally applicable competition law, would be likely to assist stakeholders in competition law compliance. We noted that there have been several significant relevant developments since the FAQs document was last updated. These include the revised Ticketing Block Exemption, the OFT’s changes to its procedures under the 1998 Act (see paragraph 15.371)\footnote{347} and its new guidance for businesses on competition law compliance\footnote{348} in addition to this investigation and relevant changes to transport legislation.

15.349 We therefore recommend to the OFT that it revise its FAQs document about the application of competition law to the bus industry to take account of these important recent developments. Stagecoach, Centro and SPT welcomed this recommendation.\footnote{349} SPT said that priority should be given to updating guidance relating to ticketing, because this involved all LTAs and operators and was a significant cost to the public purse, particularly in developing e-purse arrangements and other ticketing hardware.\footnote{350} It will be for the OFT to determine what issues it covers in this document, and in what depth, though we agreed with SPT that ticketing is likely to be an important topic for these revised FAQs (see also paragraphs 15.89 to 15.92).

15.350 Notwithstanding our recommendation that the FAQs be revised, it remains the obligation of bus operators to operate within the law. Some of the events that we have seen, particularly in the North-East of England (see Appendix 8.5), seem to reflect an operating culture in which the requirements of competition law are seen either as an irrelevant (or worse) obstruction to the local bus business, or a formalistic structure to be exploited.

15.351 It is most important that local bus operators foster a culture in which compliance with competition, as with every other, law is not seen as a technicality. We have chosen not to pursue this concern to a separate remedy because we are confident that, in the light of our report and the other measures in the remedy package, operators will review their competition compliance training and will impress upon their employees that real competition compliance is an important part of the culture of their organization. The OFT has produced a range of material to assist businesses in all sectors to achieve compliance with competition law. This includes separate written guidance for businesses and for company directors, a four-step compliance wheel and a compliance film. These tools are accessible on the OFT website. For the future, the CC may wish to ask operators for details of the compliance training of the executives and senior employees involved in transactions before them.

15.352 In addition to these general considerations, we also considered the role of each of the main elements of competition law (ie merger control, the Chapter I and Chapter II prohibitions and the market investigation regime).

\footnote{348} Available on the OFT website at www.ofg.gov.uk/OFTwork/competition-act-and-cartels/competition-law-compliance/. This includes guidance to directors on their responsibilities under competition law.
\footnote{349} Responses to the provisional decision on remedies: Stagecoach, paragraph 7.17; Centro, paragraph 5.1; SPT, paragraph 6.2.
\footnote{350} SPT response to provisional decision on remedies, paragraph 6.2.
• **Merger control**

15.353 The merger provisions of the 2002 Act enable the OFT and the CC to identify and, where necessary, remedy mergers between bus operators which lead to an SLC. We were told that, as a result of the challenging financial environment currently facing smaller bus operators in particular, some smaller operators were likely to look for opportunities to sell their businesses. Some Large Operators told us that they had already been contacted in relation to such opportunities.\(^\text{351}\)

15.354 Against this commercial background, and in light of the already highly concentrated nature of many local bus markets and the factors set out in paragraph 15.344, it will continue to be important for the OFT, as the first stage merger authority, actively to monitor mergers in the bus industry and for the OFT and CC to scrutinize those mergers which raise a realistic prospect of an SLC. We decided to recommend that the OFT applies a high priority to identifying bus mergers, making full use of bus-market-specific sources such as the specialist trade press.

15.355 Having identified a merger, the OFT decides whether or not to follow it up with an enquiry letter. The OFT told us that it would not generally send such a letter, having identified a merger, if the merger did not qualify for investigation under the 2002 Act, or if it qualified but there were no overlaps between the parties which raised potential competition concerns. The OFT also told us that it was generally unlikely to issue an enquiry letter in relation to a case where it was clear that turnover in the market involved was less than £3 million.

15.356 We noted that the OFT has exercised its discretion not to refer to the CC on de minimis grounds four bus mergers in the last three years.\(^\text{352}\) The OFT has recently updated its guidance on exceptions to the duty to refer and undertakings in lieu of reference.\(^\text{353}\) This guidance indicates that the OFT is likely to apply this exception in cases where the total value of the turnover in the market where an SLC has been identified is less than £3 million, unless there are exceptional circumstances such as significant direct consumer harm or where the merger was highly replicable in the relevant sector. In relation to the latter point, the OFT’s guidance states that, ‘The OFT will be less likely to apply the “de minimis” discretion where it believes that the merger in question is one of a potentially large number of similar mergers that could be replicated across the sector in question’.\(^\text{354}\) Where the total value of the turnover in the affected market is between £3 million and £10 million, the OFT will consider issues relating to de minimis on a case-by-case basis.

15.357 In light of the already highly concentrated nature of many local bus markets and the factors set out in paragraph 15.344, we decided to recommend that the OFT routinely follows up bus mergers where it expects to have jurisdiction and takes a cautious approach in exercising its discretion not to refer bus mergers to the CC on de minimis grounds. We further decided to recommend that the OFT reviews the application to bus mergers of its guidance on exceptions to the duty to refer. In any such review, we recommend that the OFT considers the case for indicating a lower market size threshold than £3 million, below which it is likely to exercise its discretion not to refer bus mergers. This is for the following reasons:

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\(^{351}\) FirstGroup response hearing summary, paragraph 47; Arriva response hearing summary, paragraph 39; Stagecoach.


\(^{353}\) Mergers: Exceptions to the duty to refer and undertakings in lieu of reference guidance, December 2010.

\(^{354}\) ibid, paragraph 2.40.
(a) First, there is a risk that even 'small' transactions may be removing a significant competitor (or potential competitor) within a local market. It can be difficult to evaluate the competitive impact of losing a particular operator without a detailed assessment of evidence, including the testimony of market participants and the detailed assessment of the motivation behind a transaction.

(b) Second, we have found that the conditions exist for tacit coordination to be sustained in the bus industry (see paragraph 8.242 and Appendix 8.4). There is a risk that some 'small' transactions (e.g., a depot or asset swap or transfer between neighbouring operators) could increase the likelihood for coordinated effects and/or be a manifestation of such coordination. There is a related risk that transactions that form part of an attempt by operators to achieve a coordinated outcome are 'packaged' as a merger in order to obtain merger clearance. The evidence set out in Section 8 (paragraphs 8.175 to 8.212 and Appendices 8.5 and 8.6) shows that these risks are both real and material.

(c) Third, there is a risk that a series of 'small' transactions may cumulatively result in a situation whereby a single operator has a very large share of a local market. This is recognized in the OFT's guidance (see paragraph 15.356), but it is of particular significance in bus markets.355

(d) Fourth, application of the de minimis discretion in one case may have wider adverse implications if it created an expectation that anticompetitive, but small, mergers would generally not be subject to detailed scrutiny at phase 2 or to remedial action, should an SLC be found. Again this factor is recognized in the OFT's guidance (see paragraph 15.356) but it is of particular significance in bus markets.356

15.358 There was some support from LTAs and PTEs for this remedy357 and ATCO also welcomed greater scrutiny on operator mergers.358 PTEG welcomed the CC's recommendations, although it also said that this remedy would make little or no contribution towards reducing the existing AEC.359 Nexus noted that experience locally suggested that merger control measures had done little to prevent a high degree of market concentration from arising in the Tyne and Wear bus market and therefore it had little confidence that it would do so in the future.360 Metro said that there were limited opportunities for further mergers which would increase market concentration in West Yorkshire.361

15.359 Three Large Operators had concerns about this particular remedy:

(a) FirstGroup did not consider that this remedy was necessary as there was no evidence to suggest that the OFT was not capable of applying its discretion not to refer a bus merger on de minimis grounds in an appropriate and proportionate manner, and that it already appeared to apply a cautious approach. It also stated that this remedy would make it significantly more difficult for entrepreneurs to exit and that increasing barriers to exit in such a way might in turn create disincentives to enter.362
Arriva said that it was wrong in principle and disproportionate, having regard to the AEC identified and the costs of the proposed remedies, for the CC to recommend that the OFT applies special principles in determining whether to apply its de minimis threshold to bus mergers, and that the existing regime was tough enough without adding further complications.\(^{363}\)

Stagecoach said that the CC could be regarded as seeking to extend its powers by influencing which mergers were referred to it by the OFT and that it was wholly inappropriate for the CC to use the market investigation for this purpose. It also said that the introduction of an extra-statutory regime for bus mergers would be an unprecedented step, which no other industry was subject to, and the reason for this had not been adequately explained.\(^{364}\) More fundamentally, Stagecoach also said that this remedy was ultra vires because it was not sufficiently related to any AEC identified in the CC’s provisional findings, as the CC had not considered whether the merger regime was a feature which gave rise to an AEC. It also said that this remedy was disproportionate and the CC had failed to take into account certain costs of these remedies.\(^{365}\)

15.360 We noted these submissions but did not agree with them. Our detailed assessment of competition in bus markets has identified particular characteristics, which in our judgement justify a cautious approach to merger control in this sector. We are not recommending that an ‘extra statutory regime’ be applied to the sector, rather we are making a recommendation to the OFT to take particular characteristics of bus markets into account when applying the merger control rules set out in the 2002 Act. It will remain a matter for the OFT to consider how it applies its statutory duties in relation to specific cases. As set out in paragraph 15.341, effective merger control is an important preventative measure as part of the remedy package that we have identified and addresses the AEC we have found. It is therefore a legitimate area in which the CC is entitled to make recommendations. We noted the submissions of FirstGroup and Stagecoach in relation to costs, which we consider in more detail in Appendix 15.8, paragraphs 90 to 94. We do not expect that the alleged impact on exit costs is likely to be substantial or disproportionate to the benefits of ensuring effective and vigorous scrutiny of those bus mergers that are likely to lead to an SLC.

- The Chapter I prohibition

15.361 The Chapter I prohibition of the 1998 Act provides that agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the UK and have as their object or effect the prevention, restriction or distortion of competition within the UK are prohibited unless they are excluded (section 3 of the 1998 Act) or exempt (section 2(1) of the 1998 Act).

15.362 From our investigation, we have noted that relative to other commercial sectors the number of contacts between competitors in the bus industry, in particular between Large Operators, is high. Whilst some of these contacts may take place in the context of legitimate purposes, for example LTA-facilitated discussions on partnership arrangements, we have also seen examples of other direct contacts between Large Operators. The frequency of such contacts enhances the risk that anticompetitive arrangements may occur.

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\(^{363}\) Arriva response to provisional decision on remedies, paragraph 4.1.

\(^{364}\) Stagecoach response to provisional decision on remedies, paragraph 7.3.

\(^{365}\) Stagecoach response to provisional decision on remedies, paragraph 7.2.
15.363 Direct contacts between competitors have taken place at various levels of seniority. Such discussions appear to have taken place on a one-to-one basis and to have been wide ranging in their scope, including discussions about their respective businesses and areas of operations, and the provision of commercially sensitive information relating to commercial strategies. Such communications may themselves have restricted competition or contributed to an anticompetitive outcome.

15.364 It is therefore essential for the OFT to remain vigilant to this risk and to encourage operators and individuals to bring concerns about potentially illegal coordination to its attention.

- The Chapter II prohibition

15.365 Chapter II of the 1998 Act prohibits the abuse of a dominant position, including exclusionary behaviour by dominant firms, such as predation.

15.366 The types of behaviour that are illegal under Chapter II are among the more extreme forms of conduct that contribute to the barriers to entry associated with the expected intensity of post-entry competition.

15.367 Effective enforcement of the Chapter II prohibition therefore has an important role to play in addressing these elements of the AEC. It will also help ensure that the increased opportunities for competition and market entry are not accompanied by the types of exclusionary behaviour that were observed immediately following deregulation of the industry and prior to the introduction of the 1998 Act.

15.368 We expect that some of the other measures in our remedy package will support the enforcement of this prohibition, in particular:

(a) Our recommendation that operators be required to provide more information in the registration of ‘frequent’ services (see Figure 15.2 in paragraph 15.110) will make it more difficult for a dominant operator substantially to increase frequency on a route following entry without publicizing this fact and giving notice of this intention to the Traffic Commissioner.

(b) Our recommendation to give 14 days’ additional notice to LTAs of any new local bus service registrations or changes to existing registrations (see Figure 15.2 in paragraph 15.110) will provide LTAs with an earlier opportunity to raise any concerns about potentially abusive behaviour with the OFT.

(c) Inclusion of a commitment in the Code of Conduct to comply with the 1998 Act (see Figure 15.2 in paragraph 15.110) will establish a clear link between illegal conduct and the repute of an operator, which we expect will enhance the deterrent effect of the 1998 Act. This will also support the enforcement of the Chapter I prohibition.

15.369 We have not found a need for a different legal test for evaluating accusations of abuse of dominance in the bus industry. There is a considerable body of case law and economic thinking behind the concepts of abuse of dominance and exclusionary behaviour such as predation and it is appropriate that allegations of abusive conduct are considered within this framework. We also accept that formal investigation of complaints under the 1998 Act will need to follow a thorough and fair process, that this will take time to deliver and that the OFT will need to prioritize those cases that it judges are most worthy of pursuing and cannot investigate in full every allegation that is made to it.
15.370 However, it is important that any operators which consider that they may have been subject to abusive and illegal conduct feel empowered to raise these concerns with the OFT. Likewise, it is essential that dominant operators in local bus markets consider that there is a realistic prospect of abusive behaviour being detected and of action against such behaviour being taken.\(^{366}\)

15.371 In this context, we noted the OFT’s revised procedural guidance in relation to investigations under the 1998 Act and in particular the emphasis on the opportunity for informal discussions with OFT officials prior to making a formal complaint. This mechanism may provide an opportunity for smaller operators to bring concerns to the attention of the OFT promptly and without incurring the costs of producing a formal submission. Likewise, we welcome the OFT’s commitment to aim to keep complainants informed of the progress of their complaint and to aim to communicate to the complainant within four months from the date of receipt of their complaint whether it has decided to open a formal investigation.\(^{367}\)

- Market studies and market investigations

15.372 In this market investigation, we have considered competition in all bus markets in the UK outside London and Northern Ireland. Based on our assessment, we have identified remedies, which we expect to be effective in addressing the problems that we have found. These are potentially broad in geographic scope but also capable of local implementation. Should, at some future date, further action be required to address specific competition problems in particular local markets, there may remain a role for more locally-based market studies and/or market investigations.

Partnerships

Summary of remedy

15.373 Figure 15.6 summarizes our remedy in relation to partnerships.


FIGURE 15.6

Summary of remedy relating to partnerships

We have decided to recommend that:

- LTAs consider the potential for tailoring partnerships in order to facilitate increased competition within their local areas. Partnerships with the following characteristics are likely to have the greatest potential for beneficial consequences on competition:
  
  (a) partnerships which have the effect of improving the quality of information provided to passengers, thereby increasing passenger demand for bus services and making passengers more responsive to changes in operators’ offerings;
  
  (b) partnerships which are accessible to new and/or expanding operators and have the effect of growing bus patronage and thereby improving the attractiveness of a local bus market for new and/or expanding operators; and
  
  (c) partnerships which provide an environment which promotes sustained competition, for example by encouraging service stability throughout the year.

- The DfT and the Scottish and Welsh Governments monitor progress of LTAs in delivering partnerships which have these beneficial characteristics.

- In introducing partnerships, and applying the relevant competition test, LTAs should be careful to take full account of the potential risks associated with unnecessarily raising barriers to entry, unnecessarily constraining the scope for operators to improve their service offering and facilitating coordination between competitors that goes beyond what is acceptable under competition law and what is necessary to deliver passenger benefits.

- LTAs and the OFT establish a regular forum at which the practical application of the competition test can be discussed.

- As part of its current review of BSOG in England, the DfT considers ways of incentivizing effective provision of passenger information (see Figure 15.7 in paragraph 15.423). This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

How this remedy addresses the AEC and/or resulting customer detriment

15.374 As we set out in paragraphs 12.85 to 12.97, a variety of partnership arrangements involving LTAs and operators are provided for under transport legislation in England, Scotland and Wales. The use of partnership schemes is not currently aimed at improving competition in local markets, and as we discuss in paragraph 12.99, partnership schemes have the potential to have detrimental effects on competition. Notwithstanding this, we sought views on the potential benefits for competition of partnerships, and hence the potential role that partnerships could play in addressing the AEC.

- Potential beneficial impacts of partnerships on competition

15.375 Several parties put forward arguments as to how partnerships between operators and LTAs could be used to improve competition. In particular, it was put to us that:
(a) partnerships can improve the provision of information to bus passengers;

(b) partnerships can provide a framework in which actions can be taken that would have the effect of growing passenger demand for bus services; and

(c) partnerships can be used to create a environment that promotes competition between operators that is sustained over the long term.

- **Provision of information to passengers**

15.376 The DfT emphasized the role that LTAs working together with operators to provide effective information to passengers could play in increasing competition. For example, if real time information were provided, passengers might be more inclined to wait for a specific bus instead of getting on the first bus to arrive.368

15.377 We were told that there was significant variation in the extent and quality of information provision across the reference area (see, for example, paragraphs 15.380 to 15.383 in relation to real time information systems and the first footnote to paragraph 15.256 in relation to information provided at bus stations). This diversity of experience suggested that in many instances there may be room for improvement in the quality of the information passengers are given, and the way it is provided to them. Passenger Focus told us that its research had shown that it was important to passengers to have details on fares, bus arrival times and routes at bus stops.

15.378 Operators, which determine the timetables and fares of their services, will tend to provide information to their passengers about their own services in the normal course of their operations. However, because much of the infrastructure involved in information provision (eg bus stops and most bus stations, LTA websites) is the responsibility of the LTA, it too will have a role in ensuring that information provision in an area is satisfactory.369 The role of the LTA and the benefits of cooperation in the provision of passenger information are likely to be particularly significant where an area is served by more than one operator. In light of these considerations, we took the view that partnerships could provide a useful mechanism to coordinate the efforts of operators and LTAs to deliver effective provision of passenger information provision.

15.379 We discussed real time information systems370 with a number of parties. These systems can be of benefit to both passengers and operators.

15.380 For example, Merseytravel shared with us a number of pieces of research suggesting that passengers valued real time information. These included an academic study which showed that passengers overestimated the amount of time they spent waiting for their bus, and so would benefit from a real time information system if it reduced their perceived waiting time.371

15.381 Operators too can benefit if real time information systems help to increase bus patronage. In addition, access to real time information systems may aid efficient network operation and planning. For example, Lothian Buses told us that its automatic vehicle location system allowed it to respond effectively to external factors

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368 DfT response hearing summary, paragraph 52.
369 For example, under sections 139 and 140 of the Transport Act 2000.
370 These are systems whereby the location of a bus is electronically monitored and customers are provided with electronic updates of the arrival time of their bus.
leading to delay or diversions to its services, and this had allowed it to provide a significantly higher quality of service.

15.382 Operators’ experiences with those real time information systems currently in place were not all positive, however. Stagecoach told us that many of the real time information systems that it was involved in suffered from technical problems because insufficient investment was made in the technology. FirstGroup told us that real time information was limited as to how much information could be displayed, eg often it would not say where a bus was going and who operated it, and for customers to find it useful it could require them to have some prior knowledge of the local bus network.372

15.383 The comments of a number of operators suggested that setting up and operating a real time information system could be expensive.373 As such, the benefits of putting such a system in place may not always outweigh the costs. Nevertheless, in areas where such costs are justified, a partnership can be a useful mechanism for coordinating the efforts of authorities and operators, in order to maximize the benefits of the necessary investment.374

15.384 We concluded that partnerships have an important role to play in coordinating the actions and investments of operators and LTAs to improve the provision of information to bus passengers, whether through real time information systems, through printed timetables or through other media. Better provision of information could increase patronage by increasing the attractiveness of bus travel (eg by decreasing the perceived cost of waiting for the next bus) and hence indirectly address barriers to entry by increasing the attractiveness of an area to new or expanding operators. Better provision of information is also likely to increase the likelihood that passengers will make an informed choice between rival operators on the basis of their offering, rather than simply get on the first bus that arrives, thereby mitigating the contribution of certain aspects of consumer behaviour to the AEC. In these ways, we concluded that better provision of information to passengers could indirectly help to address the AEC, as well as delivering better outcomes.

- **Growing passenger demand**

15.385 Second, several parties noted that partnership working could provide a framework in which actions could be taken (eg coordinated investments by LTAs and operators) that would have the effect of growing passenger demand for bus services. This, in turn, would make the local bus market in question more attractive to new entrants and in this way stimulate competition.

15.386 For example, in Nottingham, the LTA told us that the statutory quality partnership (SQP) had reduced congestion and in this way improved reliability and decreased journey times. Comments from operators suggest that this should make Nottingham a more attractive place to operate (see Appendix 12.2 for more information about the Nottingham scheme). Arriva gave a number of further examples of how, given the importance of punctuality and reliability to customer satisfaction and bus usage, LTAs

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372 FirstGroup response hearing summary, paragraph 45.
373 For example, Stagecoach and Lothian Buses suggested that effective real time information systems were expensive to implement.
374 The point that providing additional information can also have costs and that these must be traded off against the benefits of additional information was highlighted by various parties. For instance, as pointed to by Rotala in its response to the provisional decision on remedies, providing information that is comprehensive and complete could be expensive and this could discourage entry among smaller operators. In its response to the provisional decision on remedies, Nexus told us that introducing additional information about fares could increase complexity, and that this may prevent customers from identifying the best value ticket.
could play an important role in stimulating demand for bus journeys. These included (among others) measures to reduce illegal and inconsiderate parking, reduce misuse of bus lanes, improve highway management and improve bus access to town centres. ALBUM gave the examples of improved traffic management or assistance with marketing and information as measures which might be taken by an LTA within a partnership scheme in order to improve the operating environment for buses, and so in this way attract new entrants.375

15.387 We concluded that partnerships that had the effect of growing bus patronage could indirectly address the barriers to entry and expansion that we have identified as causing the AEC by increasing the attractiveness of the local bus market to new and/or expanding operators.376 For this type of beneficial effect to arise in practice, such partnerships would need to be accessible to new or existing operators that are willing to participate, and the operator requirements would need to be proportionate, such that these operators were able to meet them.

o Promoting sustained competition

15.388 Third, several parties highlighted the ways in which partnerships could be used to create an environment that would promote competition between operators that was likely to be sustained over the long term, for example by:

(a) Putting in place transparent and fair methods of managing scarce road capacity in busy city centres while facilitating competition to operate bus services within these cities. We were told about such arrangements in Nottingham and Merseyside—more detail on the obligations included in the partnerships in these areas and parties’ views on those arrangements is set out in Appendix 12.2.

(b) Identifying a limited number of specific dates on which service changes take place each year. For example, a condition of the partnership arrangement in Nottingham city centre stipulates that service changes are limited to six pre-specified dates in the year (see Appendix 12.2), and we were told about voluntary arrangements in SYPTE and Metro to keep service changes to a maximum of four and six in the course of a year respectively.377

(c) Conducting targeted network reviews of commercial and supported services. Rotala told us that this provided a valuable function of maintaining service level and managing network changes if managed well.378 In addition, Centro told us that these reviews could stimulate competition, giving the example of a partnership scheme in the West Midlands in which participating operators were all encouraged to propose improvements to their services at the same time as part of a network review. The knowledge that rival operators might be looking to expand their services as part of the review could place competing operators under pressure to maintain good levels of service themselves.

(d) Precluding behaviour that would constitute ‘cheap exclusion’ (see paragraph 8.275). The DfT told us that many of the practices that constituted ‘cheap exclusion’ could be addressed by a quality partnership scheme.379 For example, in

375 ALBUM response to Remedies Notice, p18.
376 In its response to the provisional decision on remedies, PTEG said that increased patronage would also create a strong incentive for the incumbent to protect their own market. We summarize the market-opening measures that we have proposed in order to address barriers to entry that we have identified in the local bus market (set out in Section 9) in Figures 15.1, 15.2 & 15.3.
377 SYPTE response hearing summary, paragraph 41; Metro response hearing summary, paragraph 21.
378 Rotala response to Remedies Notice, paragraph 11(f).
379 DfT response to Remedies Notice, paragraph 72.
Paisley an SQP was recently introduced that, among other conditions, required operators to adhere to published timetables and ensure the punctuality and reliability of their services, and to meet certain minimum vehicle and driver standards. SPT told us that, prior to the partnership agreement, the number of traffic regulation violations in the area had been in the hundreds but following the introduction of the SQP and the constant monitoring, the number had fallen to a handful.380

(e) Developing agreements between operators to accept each other’s multi-journey tickets on particular corridors (see also our discussion of ticketing in paragraphs 15.11 to 15.109). We were told about such arrangements in Oxford and Merseyside.

(f) Developing qualifying agreements between operators to run even headways on particular corridors, while continuing to compete on other dimensions (eg fares and quality of service). Nexus told us that these agreements could be effective in producing even headways and thereby stimulating demand.381 Stagecoach told us that Qualifying Agreements could be designed to generate efficiencies in a way that would minimize competition concerns.382

15.389 In response to the provisional decision on remedies, PTEG submitted that head-to-head competition may be inherently unstable because of the incentive for operators to time services immediately in front of their rivals, arising from the economic characteristics of bus services, in particular the perishable nature of the bus product and the behaviour of bus passengers. It questioned whether improved information arising as a result of partnership working could be used to promote new entry and sustained competition because of this.383

15.390 Similarly, Nexus questioned whether measures to promote entry could be introduced without these having a destabilizing impact.384

15.391 In paragraphs 8.41 to 8.60, we discuss in detail the particular features of demand and supply in the local bus market which can combine to have a destabilizing impact on head-to-head competition. We do not agree, however, that a deregulated bus market is incapable of sustaining head-to-head competition. We have identified circumstances under which head-to-head competition is more likely to be sustained, for example where operators compete head-to-head along part of a route (see paragraphs 8.86 to 8.81). Moreover, we expect the measures in relation to operator behaviour summarized in Figure 15.2 in paragraph 15.110 to increase the likelihood of competition being sustained, compared with the current operation of bus markets (see paragraphs 15.111 and 15.112). Partnerships of the types summarized in paragraph 15.388 can support these measures. For example, limiting changes to service frequency to specific dates (see paragraph 15.388(b)) is likely to reinforce the impact of the extended notice periods for changes to registration and further reduce the likelihood of consecutive ‘tit-for-tat’ changes to service registrations. Similarly, as set out in paragraph 15.388(d), a local quality partnership can reinforce and provide local context to the Code of Conduct that we have recommended be introduced to address cheap exclusion.

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380 SPT response hearing summary, paragraph 38.
381 Nexus response to provisional decision on remedies, paragraph 7.3(f).
382 Stagecoach response to provisional decision on remedies, paragraph 8.7.
383 PTEG response to provisional decision on remedies, paragraph 8.5. PTEG also told us that information in many PTE areas was now available in operator-neutral format and via a variety of mediums, including real-time systems. Given this, PTEG considered it unlikely that the gap in information would be significant enough to attract new entrants to the market: PTEG response to provisional decision on remedies, paragraph 8.6.
384 Nexus response to provisional decision on remedies, p5.
15.392 We concluded that, subject to the detail of their implementation, the measures set out in paragraph 15.388(a) to 15.388(e) all have the potential to promote sustained competition between bus operators. In particular, they can help to reduce the barriers to entry associated with destabilizing pressures on competition, as set out in paragraph 9.213, and have the potential to reinforce, at a local level, our remedies in relation to ticketing (see Figure 15.1 in paragraph 15.11 and operator behaviour (see Figure 15.2 in paragraph 15.110). In introducing these types of measure, however, LTAs will need to be mindful of the potential risks as well as potential benefits to competition. For example, in Nottingham, incumbents are given priority in the slot allocation process and smaller operators have raised concerns that they are not able to access those bus stops which are already fully booked. This example is discussed in more detail in Appendix 12.2.

15.393 We decided that Qualifying Agreements, if properly overseen by LTAs, may also have the potential to promote sustained competition (see paragraph 15.388(f)). However, given the more limited role of LTAs in these agreements, LTAs will need to pay careful attention to these schemes to ensure that they are in the interest of passengers, that they do not unnecessarily prevent or restrict competition, and that wherever possible they contain provisions to ensure that some form of competition between operators is retained.

- Parties’ comments on using partnerships to promote competition

15.394 In their responses to our provisional decision on remedies, a number of parties told us that public interest rather than competition was the most important consideration in setting up a partnership agreement.385 Furthermore, some LTAs told us that there was a fundamental tension between using some forms of partnership agreements to advance the public interest and to promote competition.386

15.395 We recognize that the public interest will be LTAs’ principle consideration when they are considering introducing partnership agreements. Furthermore, in certain instances, because of the nature of the problem that they are addressing, partnerships will restrict competition to some limited extent. For example, if there is very clear evidence that very high frequency on a certain corridor is against the public interest because of its negative impact on congestion, then a partnership that reduces frequency on this corridor will limit the scope for frequency competition between operators on the corridor.

15.396 A number of PTEs told us that partnerships had not been successful in promoting competition in the past.387 For example, SYPTE told us that the partnership in South Yorkshire had not itself increased competition, and that while there had been increased competition in Barnsley, this was related to patronage growth resulting

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385 For example, ATCO told us that ‘public interest should be the most important criteria when assessing whether aspects of a partnership are acceptable, not the impact on competition per se’. Cheshire and West Chester Council told us that ‘the prime aim [of partnerships] should be for the sustainable improvement of the overall experience to retain and attract users of bus services and other public transport … one would hope that competition would be stimulated as a consequence of strengthening a vibrant market, as opposed to facilitating increased competition being the first objective’. PTEG told us that ‘at a fundamental level we do not accept that the primary benefit and objective of partnerships is that they have the theoretical possibility of resulting in more on-street competition. From our perspective, partnerships are about operators and LTAs working together with the objective to achieve long term growth in the bus market’.

386 See SYPTE response to provisional decision on remedies, paragraph 5.2; Nexus response to provisional decision on remedies, paragraph 7.1; PTEG response to provisional decision on remedies, paragraph 8.2. For example, PTEG told us that it was unlikely that a partnership agreement could both regulate timetables and encourage low-quality entry, as new entrants could, for example, erode incumbents’ profit margins by running additional services just ahead of scheduled times. PTEG response to provisional decision on remedies, paragraphs 8.13 & 8.14.

387 Specifically, Metro told that there were a wide range of partnerships in place in West Yorkshire, but no evidence of these partnerships resulting in significant sustained competition. Nexus told us that it was not aware of any instances of new entry into a market as a direct or indirect result of the introduction of a partnership.
from aspects of the partnership agreement making the market more attractive, rather than as a result of the partnership agreement itself. We are not aware of partnerships being used to encourage competition in the past. Stagecoach told us that ‘the recommendations [for LTAs to consider the potential for tailoring partnerships in order to facilitate increased competition within their local areas] will necessitate a change in focus by the LTAs, since, currently, increasing standards tends to be the main objective of the LTA, rather than increasing competition’. The idea that LTAs do not currently see partnerships in this light is also borne out by the responses of the PTEs to our provisional decision on remedies. As such, that partnerships have not positively impacted upon competition is likely to reflect the limited attention given to pro-competitive provisions in previous schemes, rather than a more fundamental inability of partnerships to promote competition as part of a package of measures. The example given by SYPTE supports the potential for partnerships to encourage competition by promoting patronage growth.

- **Conclusions on the scope for partnerships to address the AEC**

15.397 Having considered the evidence, we conclude that carefully designed and implemented partnerships between LTAs and operators can play a role, in support of the other elements of the remedy package, in remedying the AEC that we have found. In particular, we conclude that partnerships with the following characteristics are likely to have the greatest potential for beneficial consequences on competition:

(a) partnerships which have the effect of improving the quality of information provided to passengers, thereby increasing passenger demand for bus services and making passengers more responsive to changes in operators’ offerings;

(b) partnerships which are accessible to operators outside the agreement and have the effect of growing bus patronage and thereby improving the attractiveness of a local bus market for new and/or expanding operators; and

(c) partnerships which provide an environment which promotes sustained competition, for example by encouraging service stability throughout the year.

15.398 If carefully implemented, such partnerships have the potential to reduce the barriers to entry that we have identified as contributing to an AEC in markets for local bus services.

15.399 In our view, therefore, partnerships can play a role in promoting competition. As we have set out, certain types of partnerships are likely to stimulate competition. The positive effect that partnerships can have on competition between bus operators does not appear to have been fully recognized to date, and can itself provide a case for introducing new partnership agreements on public interest grounds. For these reasons, we disagree that there need be an inherent tension between partnerships and competition, or that any such tension could not be resolved.

15.400 Equally, in instances where a proposed partnership has features that would in some way restrict competition, it is very important that sufficient attention is given by LTAs to consider whether provisions could also be included in the design of that agreement that would retain or promote competition between operators while preserving the public interest benefits of the partnership. For example, it is important (and indeed in the public interest) that competition between operators is retained as far as is possible within a partnership that regulates operators’ frequencies on a certain corridor, by making sure that restrictions are kept to a minimum and that the terms of the partnership allow competition on non-frequency variables such as fares and quality.
Thus, although we have emphasized their potential benefits for competition, we are also aware of the competition risks of partnerships (set out in paragraph 12.99). Given these risks, it is important for LTAs to ensure that efforts are taken such that partnerships do not unnecessarily exclude operators or deter entry, do not unnecessarily constrain the scope for operators to improve their service offering and do not facilitate coordination that goes beyond what is acceptable under competition law and what is required to deliver benefits to passengers. LTAs should give each of these potential detrimental effects full consideration when they are considering introducing a partnership scheme and applying the competition test. By doing so, LTAs will be able to ensure that sufficient recognition is given to reducing any potential negative impacts that a partnership scheme could have on the public interest if that scheme removes or weakens incentives for the local bus operators in an area to compete to offer passengers a good service.

Review of legislation, regulation and guidance relating to partnerships

In the Remedies Notice, we asked whether any changes were required to current legislation, regulation or guidance to facilitate the use of partnerships as a remedy option.

The majority of bus operators, and some LTAs, commented that existing mechanisms (both voluntary and statutory) were sufficient to deliver effective partnerships. Go-Ahead told us that the Local Transport Act 2008 (the 2008 Act) legislation was still ‘bedding in’.

Some parties suggested possible changes to the policy framework governing partnerships. In particular:

(a) Arriva stated that partnerships with local authorities were particularly likely to be effective in stimulating demand in the bus market if the Highway Authorities were involved as well. This was because some of the infrastructure decisions that affected the operation of local bus services (e.g. junction layout, bus lanes, roadworks) were taken by the local Highway Authorities rather than the LTA, and so may fall outside the scope of a partnership agreement between the LTA and operators. Arriva gave Leicester as an example of an area where the decisions of the Highway Authority had affected its operations—here the Highway Authority had, on some occasions, failed to take the impact of roadworks on public transport into account, or to engage in proper discussion with bus operators about planned road works prior to the event.

(b) TfGM told us that a review of the current competition tests applying to partnerships would be beneficial to assess whether they could play a greater part in addressing the detrimental effects on customers resulting from the AEC.

(c) TAS told us that, in its experience, both operators and local authorities were perhaps over-cautious in their approaches to partnerships and were particularly averse to doing anything which may be seen as ‘anti-competitive’. TAS made two suggestions for change:

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388 For example, City of York Council (p10), Arriva (p45), Stagecoach (p47) and Rotala (p12) all submitted comments to this effect in their responses to our Remedies Notice.

389 TfGM response to Remedies Notice, p27.
(i) that pursuance of partnerships would be greatly aided by the issue of updated
and simpler guidance from the OFT on the application of the competition
tests; and

(ii) that it saw no fundamental reason why a simple partnership could not be
arranged between operators without reference to the LTA or LTAs involved.
‘Non-inclusive’ partnerships would be notified to, for example, the Traffic
Commissioner and any LTA involved in much the same way as a Local Bus
Service was registered. Any LTA would be free to refer to the OFT any
partnership it found to be anticompetitive or which it felt amounted to a cartel.
However supportive, LTAs could delay progress in partnerships significantly
as the wheels of local government turned slowly and the LTA might have
other priorities.390

(d) SPT told us that by strengthening current legislation in Scotland in relation to
quality contracts and partnerships, greater benefits for the passenger could be
achieved. The legislation as it currently stood was cumbersome and problematic
to implement in practice, and should this be addressed, it was likely that more
effective partnerships would be implemented across the West of Scotland.391
Similarly RTPs Scotland told us that the strengthening of existing legislation on
quality partnerships should be considered as this could deliver some of the bene-
fits of franchising within the context of the current bus market and legislation.392

(e) PTEG393 and SYPT394 made two suggestions for change to legislation in
England regarding partnerships:

(i) First, remove the ability to make admissible objections. The ability of oper-
ators to make admissible objections to standards in an SQP relating to maxi-
mum fares and frequencies were unnecessary. The ability to exert an element
of control on maximum fares in near monopoly situations was important, as
was the ability to coordinate frequencies and timings. The requirement for an
SQP to meet the competition test was sufficient safeguard. In reality, the pro-
visions on maximum fares did not go far enough to control fares effectively in
monopoly situations.

(ii) Second, to remove the requirement for an LTA to provide ‘facilities’ in order to
implement an SQP. This requirement was one reason why only a few SQPs
had been brought forward and should not be seen as a necessary require-
ment to raising operating standards on a corridor.

(f) Centro told us that it would welcome legislative improvements that would make it
easier to bring non-participating operators into the agreement for such things as
monitoring and performance and that it would welcome reform to make it simpler
and easier to introduce SQPs where these were deemed relevant to both oper-
ators and LTAs for development of quality in the network.395

391 SPT response to Remedies Notice, paragraph 7.23.
392 RTPs Scotland response to Remedies Notice, p2.
393 PTEG response to Remedies Notice, paragraph 11.4.
394 SYPT response to Remedies Notice, p18.
395 Centro response to Remedies Notice, p4.
(g) Nexus told us that legislation would need to be strengthened to support the mandating of partnerships by an LTA, as opposed to the current emphasis of a negotiated voluntary arrangement.\(^{396}\)

(h) PTEG and Centro told us that LTAs should be given additional powers to require data from operators, in order to allow them to monitor the success of partnership schemes. Similarly PTEG and TfGM told us that the ability to require information—for example, by means of regulatory accounting (see paragraphs 15.471 to 15.475)—would make them more informed when negotiating the specification of a partnership scheme with operators, better enabling them to judge the impact of a scheme on competition.

15.405 We considered these suggestions carefully. We noted first that the legislative framework governing quality partnerships is relatively new, particularly in England and Wales, and that bus operators and LTAs were therefore likely still to be exploring the options available to them under existing legislation.

15.406 We set out in Section 12 and Appendix 12.1 that there are differences in the legislation governing how partnerships can operate between the nations in the reference area. For example, not all the changes made in the 2008 Act relating to quality partnership schemes have been made in Scotland.\(^{397}\) In its response hearing, the Scottish Government said that the legislation in its current form was flexible, and that when it had offered transport authorities policy assistance in order to encourage partnerships, they had not identified any features of the quality partnership legislation that were causing them problems. We note that partnerships have been introduced in Scotland, and that the Scottish Government had recently provided guidance on competition issues relating to the implementation of partnerships. We concluded that it was not necessary to change Scottish legislation in order to realize the potential benefits of partnerships for competition.

15.407 With respect to the suggestion from Arriva in paragraph 15.404(a) about the involvement of Highway Agencies in partnerships, we agreed that close working between LTAs and Highway Agencies (where these were different bodies) was likely to help ensure that the benefits of partnerships for competition and bus passengers were maximized.

15.408 We considered the comments about the competition test and accompanying guidance raised in paragraph 15.404(b) and 15.404(c)(i). In our view, the proper application of the relevant competition test is an essential component of partnership working, given the potential risks of partnerships for competition that are set out in paragraph 12.99.

15.409 With these comments in mind, we reviewed the DfT/OFT guidance and considered how the competition test had been applied in partnership agreements in Chester and Nottingham (see Appendix 12.2 for more details of these agreements).\(^{398}\) We concluded that the guidance covered the key issues, though we agreed with TfGM that it could usefully be kept under review in the light of experience of developing partnerships and applying the test. We noted that the potential benefits of partnerships for competition do not appear in the guidance, and that no advice exists regarding meas-

\(^{396}\) Nexus response to Remedies Notice, p18.

\(^{397}\) See Appendix 12.1, paragraph 76.


ures authorities might take to tailor the specifications of partnership agreements to promote or retain competition.

15.410 We further observed that the supervision of the competition test generally relies on operators or other interested parties outside the partnership agreement complaining to the OFT, in order for it to investigate whether its provisions are met. In some cases, however, other operators may not have any reason to complain about potentially anticompetitive partnerships and individual passengers or passenger groups may not have the resources or the information to raise concerns. This places an extra responsibility on the LTA to assess effectively the competitive impact of a partnership scheme.

15.411 We also noted that SQPs have only recently started to be introduced in substantial numbers, and so there may be some value in revisiting the guidance with reference to ‘live’ cases.

15.412 Based on the considerations in paragraphs 15.408 to 15.411, we decided that there was likely to be value in establishing a forum in which the OFT and LTAs were able to discuss issues arising in relation to the application of the competition test to partnerships and qualifying agreements. Building on the existing published guidance, such a forum would enable LTAs to benefit from OFT advice on competition matters and from each other’s experience and would enable the OFT to keep in touch with the specific competition issues that are arising in relation to current and proposed partnerships and agreements. In addition, it would also give LTAs a chance to seek and share advice on how partnership agreements might be used to promote competition.

15.413 In their responses to our provisional decision on remedies, some parties suggested that it would be valuable for other stakeholders to take part in such a forum. Specifically, ALBUM and Stagecoach suggested that operators should be represented (Stagecoach suggested that this role could be played either by the operators themselves or by a representative body). Cheshire West and Chester Council said that it would be appropriate for ATCO, Passenger Focus and the Confederation for Passenger Transport to attend.

15.414 In addition, TfGM told us that the forum should be capable of (a) addressing specific issues relating to competition law in the area which may arise as a result of new technological or operational developments and (b) advising in a timely fashion on the application of the competition test to specific partnership proposals.

15.415 Although we leave the exact format as a matter for the OFT and LTAs to determine, we agree with the suggestion that it could be useful to have other parties (in particular operators) attend the forum. We also agree that specific issues relating to competition law which may arise as a result of new technological or operational developments would be a suitable area for the forum to cover. While the forum should be practically focused and discuss real examples, we expect the forum to provide general guidance that is relevant to all LTAs on assessing the impact of partnerships on competition, rather than for it to serve as a vehicle for the OFT to make judgements on LTAs’ specific partnership proposals prior to them being introduced.

15.416 We were not attracted by the suggestion in paragraph 15.404(c)(ii) that LTAs could be excluded from partnership arrangements. In our view, the partnership between the LTA and operators, rather than the coordination between operators, is the key benefit of any partnership arrangement. Excluding LTAs from partnership arrangements is likely to reduce the likelihood that partnerships act to the benefit of passengers and
increase the risk that partnerships are used to exclude competitors or as a forum for collusion.

15.417 Similarly, we were not attracted by the various suggestions in paragraph 15.404(d), (e), (f) and (g) from PTEG and PTEs to remove the obligation on LTAs to contribute to the partnership in terms of investment, to remove the ability of operators to make admissible objections, or to choose not to participate. The principle of joint working by LTAs and operators to achieve a common goal of growing bus patronage is a fundamental characteristic of partnership working, and we concluded that replacing this with a mandatory or regulatory solution was likely to be a retrograde step.

15.418 We considered the suggestion in paragraph 15.404(h) that LTAs be given additional powers to require information from operators. We do not believe that giving LTAs additional powers to require information from operators is a necessary condition for partnerships to play a successful role in promoting competition, and have received no evidence that this is the case. Nevertheless, we suggest that as LTAs gain more experience of using partnerships to promote competition, the DfT and Scottish and Welsh Governments keep under review the need for such additional powers.

15.419 We decided that there was no need for changes to the existing legislative framework governing partnerships. In our judgement, the existing legislation, as it applies in England, Scotland and Wales, is sufficient for LTAs in each of those nations to work with operators to develop partnerships to grow bus patronage and promote competition.

Implementation of remedy

15.420 Decisions in relation to specific partnerships are inherently local in nature and are ultimately for the LTA to take, subject to careful competition scrutiny of proposals by reference to the relevant competition provisions.

15.421 We therefore decided that our remedy in this area should take the form of a recommendation to LTAs, as set out in Figure 15.6 in paragraph 15.373, setting out the characteristics of partnerships which are most likely to have beneficial effects on competition and the risks to which LTAs should pay particular attention when introducing partnerships. Consistent with the approach that we have taken in ticketing (see paragraph 15.108), we recommend that the DfT and the governments of the devolved administrations monitor progress of LTAs in delivering partnerships which have these beneficial characteristics.

15.422 To further encourage improvements in relation to information provision, we decided to recommend to the DfT that, as part of its current review of BSOG in England, it considers ways of incentivizing effective provision of passenger information (see Figure 15.7 in paragraph 15.423). This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review. With respect to the application of the competition test, we recommend that the OFT establishes a regular forum in which the practical application of the competition test can be discussed with LTAs and other stakeholders, both in the context of schemes that have recently been introduced and schemes that are under consideration.
**Bus Service Operators Grant**

**Summary of remedy**

15.423 Figure 15.7 summarizes our remedy in relation to BSOG.

**FIGURE 15.7**

**Summary of remedy relating to BSOG**

<table>
<thead>
<tr>
<th>We have decided to recommend that, as part of its current review of BSOG in England, the DfT considers ways of incentivizing the following activities:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) development of, and participation in, effective multi-operator ticketing schemes;</td>
</tr>
<tr>
<td>(b) compliance with competition law and the Code of Conduct; and</td>
</tr>
<tr>
<td>(c) investments through partnership arrangements aimed at growing passenger demand including, in particular, investments to improve the quality of information provided to passengers.</td>
</tr>
</tbody>
</table>

The Scottish and Welsh Governments may wish to have regard to this recommendation in any future review of BSOG in Scotland and Wales.

15.424 In its response to the Remedies Notice, the DfT noted that it paid around £318 million in 2009/10 in BSOG outside London in England and the Government had announced that it ‘will work with bus operators and local government to examine smarter ways of administering this subsidy to get better results for passengers and taxpayers’. As part of this process, the DfT said that it would welcome thoughts from the CC on whether this support could be used to improve competition and passenger outcomes.\(^{399}\)

15.425 Our assessment of the impact on competition of current policy relating to BSOG is set out in paragraphs 12.18 to 12.23, where we concluded that since BSOG applies equally to all local bus operators, it would not distort competition between them.

15.426 In our view, decisions about the amount of public subsidy to devote to this sector are properly a matter for government. We also noted that BSOG was a devolved matter. However, in light of the DfT’s invitation, we considered whether BSOG or similar subsidies could be used to promote competition and remedy the AEC that we have found.

15.427 We decided that the DfT’s review of BSOG provided an opportunity to enhance the effectiveness of a number of these measures. In particular, to maximize the impact of the remedies that we have decided to take forward, we have decided to recommend that, as part of any review of BSOG in England, the DfT considers ways of incentivizing the following actions and activities:

- (a) development of, and participation in, effective multi-operator ticketing schemes;

- (b) compliance with competition law and our Code of Conduct; and

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\(^{399}\) Response to Remedies Notice, paragraph 27.
(c) investments through partnership arrangements aimed at growing passenger demand including, in particular, investments to improve the quality of information provided to passengers.

15.428 We note that BSOG is a devolved matter and that the application of BSOG in Scotland and Wales is different from in England. For these reasons, we have not made a specific recommendation to the Scottish and Welsh Governments, though they may wish to have regard to this recommendation in any future review of BSOG in Scotland and Wales.

15.429 There were a range of views from parties regarding this remedy. Various parties broadly welcomed this remedy, including the DfT, some LTAs and one medium-sized operator. In particular, we note the DfT’s response which stated that it was grateful for the CC’s thoughts on how BSOG might be reformed and that it would consider the CC’s recommendations as part of its review, the outcome of which was expected to be announced by March 2012.

15.430 There were also some concerns about the remedy and its implementation. A number of parties considered that it was unfair to link BSOG to a number of benchmarks in which operators may have no control, for example where there was no demand for a multi-operator ticketing scheme, or where provision of timetable information was dependent on local authorities. ALBUM and Centro said that there was a danger that the link between BSOG and fuel duty would be broken and its original purpose would be lost. Some parties also stated that there would be difficulties in linking BSOG to compliance with competition law. PTEG referred to a number of challenges about how this remedy could be practically achieved and thought that PTEs were best placed to target BSOG support in a way that best met local circumstances. TfGM suggested that BSOG could be used as a way of incentivizing operators to cooperate on a voluntary basis with the implementation of the remedies, in advance of legislation required to enforce their implementation. We consider that these are issues which the DfT could take into consideration as part of its review.

15.431 One further concern raised by some parties was that the remedy may have state aid implications, as it may have the potential to distort competition, and may therefore require the approval of the European Commission. We have considered this issue further. Whether state aid approval will be required is a matter to be determined by the DfT once it has completed its review and will depend on the nature and extent of the modifications that it is proposing to implement at the time. It is not possible to determine at this stage precisely how long it would take to obtain approval. However, we note that the DfT has not raised any concerns to us in this regard.

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400 See paragraphs 12.20–12.24.
401 See response to provisional decision on remedies: Rotala, paragraph 35; the DfT, paragraph 9; Kent County Council; the West of England Partnership, p1; B&NES, p3; and SPT which also stated that it would welcome a review by the Scottish Government to be taken forward at an early opportunity (paragraphs 8.1 & 8.2).
402 DfT response to provisional decision on remedies, paragraph 9.
403 Response to provisional decision on remedies: Go-Ahead, paragraph 6.2; ALBUM, p9; EYMS, p4; Centro, paragraphs 7.1–7.2.
404 Response to provisional decision on remedies: ALBUM, p9; Centro, paragraph 7.2.
405 PTEG response to provisional decision on remedies, paragraphs 11.2–11.4.
406 For example, Go-Ahead stated that this would be outside the remit of the DfT and may mean that operators were unfairly penalized: response to provisional decision on remedies, paragraph 6.4. See also response to provisional decision on remedies: ALBUM, p9.
407 PTEG response to provisional decision on remedies, paragraphs 11.2–11.4.
408 TfGM response to provisional decision on remedies: Stagecoach, section 9; Go-Ahead, paragraph 6.5; FirstGroup, paragraph 10.2; PTEG, paragraph 11.3; CPT, p2.
Stagecoach also stated that the other remedies, if properly designed, would be a proportionate and effective response to the alleged AEC. We consider further how the various elements of the remedy package contribute to remedying the AEC in paragraphs 15.497 to 15.515.

**Other options that we considered**

We considered a number of other remedy options that we have decided not to include in our remedy package. These are:

(a) franchising/quality contracts;

(b) regulatory accounting;

(c) prohibitions on owning and/or managing bus stations;

(d) restrictions on pricing behaviour; and

(e) divestiture and price controls.

**Franchising/quality contracts**

We considered whether to recommend the introduction of franchising by means of a Quality Contract Scheme (QCS) as a remedy, either on a widespread basis or within specific local markets. Our detailed consideration of the evidence relating to this remedy option is contained in Appendix 15.6.

We identified two ways in which franchising could be introduced as a remedy:

(a) First, area-wide franchising could be used to introduce competition ‘for the market’ in relation to the services included within the scope of the franchise in place of competition ‘in the market’. In this scenario, franchising would apply to all routes within a geographic area, and there would be no scope for head-to-head competition within this area for the duration of the franchise. Within the franchise area, tenders may be specified at the route level, for defined packages of services within the franchise area, or at a network level.

(b) Second, selective or temporary franchising might be used as a market-opening measures, aimed at increasing ‘in the market competition’ in nearby non-franchised markets. This could be the case where a proportion rather than all of the routes in an area are franchised. If the consequent franchise package were of sufficient scale, this could be attractive to operators that wish to expand within the local area.

We consider each of these approaches separately below.

**Area-wide franchising to introduce ‘competition for the market’**

A number of LTAs told us that they were actively considering the introduction of some form of area-wide franchising and some (SYPT, Nexus and Metro) were in the process of developing proposals for the implementation of QCSs. By contrast,
most operators were strongly opposed to the introduction of any form of franchising (see Appendix 15.6, paragraphs 10 to 18).

15.438 We consider first how area-wide franchising could be introduced as a remedy, whether it could address the AEC and/or customer detriment, whether it is a practicable solution and what the possible impacts on market outcomes might be, in particular efficiency, costs and innovation. We then compare area-based franchising with our package of remedies.

- **Impact of area-wide franchising on AEC and/or detriment**

15.439 We looked first at whether area-wide franchising had the potential to address the AEC and/or resulting customer detriment (see Appendix 15.6, paragraphs 19 to 52).

15.440 We did not find that area-wide franchising would address the AEC directly. Generally, area-wide franchising restricts and sometimes removes competition from within the relevant franchised area for a period of time. Franchising is a mechanism that can be used to seek to improve certain characteristics of the bus services in an area (eg low prices, high frequencies). In a franchised bus market, this could be achieved through the introduction of a competition between operators to supply bus services in an area for a period of time. In principle, therefore, area-wide franchising could be introduced to address the detrimental effects we have identified and as such represent an indirect solution to the AEC that we have identified.

15.441 The extent to which area-wide franchising would, in practice, address the customer detriment we have identified will largely depend on the design and implementation of the franchising mechanism. This in turn will determine the incentives and opportunities open to operators to run that franchise, including the extent of barriers to participating in the bidding process:

(a) The incentives and opportunities for running a franchise will be set out in the franchise specification. For example, the specification will set out the franchise area, the franchise method (route, area or network), the franchise length, the number of operators permitted to operate in the area (typically one), and other requirements for operating that franchise (eg maximum prices and minimum frequencies). Certain of these specifications will be fixed, whilst others will be open for the operators to bid on.

(b) Barriers to entry and expansion under a franchise model change from those associated with entering against an incumbent operator to those associated with the auction process. At the point of the auction, barriers may be lower than under a deregulated model as an efficient operator does not have to contend with factors such as post-entry competition, network strength and cheap exclusion. However, some sunk costs will be incurred associated with the auction process and there may be incumbency advantages, particularly in relation to the first auction. In addition, the barrier to entry we found in some local areas associated with access to depots may also remain under franchising.

15.442 We conclude that area-wide franchising would remove the scope for competition within the market and so would not address the AEC directly. However, area-wide franchising could potentially reduce the customer detriment that we have identified and as such, represent an indirect solution to the AEC that we have identified. It would do this by controlling outcomes (eg price, frequency) in the franchised area through the introduction of a competition for that franchise.
Practicability of area-wide franchising

15.443 Next we considered whether competition for a franchise would be an effective mechanism, in practice, to achieve the outcomes that are needed to address the customer detriment that we have found. In particular, we considered the practicability of introducing area-wide franchising in place of the current, mainly deregulated, market model (see Appendix 15.6, paragraphs 53 to 76).

15.444 We noted that an area-wide franchising model was in place in London and in many other European cities. The evidence that we reviewed of the London market (see Appendix 15.6, Annex B) indicated that London Bus Services Limited (LBSL) was generally able to secure effective competition between several operators for the contracts that it put out to tender. This indicated to us that franchising was, in principle, a practicable alternative to competition 'in the market', and could be made to operate successfully. However, we also noted that there were a number of material practical challenges and risks associated with introducing effective area-wide franchising within the reference area. In particular:

(a) Moving to area-based franchising would require LTAs to acquire and develop additional skills and capabilities, in areas such as network design and monitoring. Such skills may be in short supply and/or may take time to develop in-house. This would increase the risks associated with introducing area-based franchising and the timescale for area-based franchising to deliver results. We noted that some PTEs have experience of large tenders and network design across different transport modes and as such may possess some of the necessary skills in-house.

(b) LTAs are likely to face an information asymmetry relative to incumbent operators in relation to the likely commercial performance of routes to be included in an area-based franchise. Although these risks could be mitigated by requiring commercial operators to provide LTAs with route information and LTAs hold some passenger survey data allowing limited estimation of travel demand, there still exists a material risk that the network and contracts would be misspecified at least in the short to medium term.

(c) There are transitional risks associated with the potential for network disruption during the transitional period between a franchise being awarded and it commencing. In addition, incumbent operators may be subject to financial risks associated with employee transfers, if they do not win the contract.

15.445 In this context, we noted that LBSL had a number of specific advantages in operating its franchise model—for example, it had retained the network planning function following privatization, and has detailed information about network performance—which LTAs would not be as well placed to replicate within a short period of time.

15.446 We conclude that these risks are individually material and are likely together to present significant practical difficulties for LTAs (including PTEs) in successfully implementing an effective franchise model. As a result, we judged that these risks could detract from the effectiveness of franchising as a remedy option and add to the

411 LBSL—a subsidiary of TfL—is the authority in charge of procuring bus services in London. It plans the network, specifies service levels and ensures service quality, as well as taking responsibility for local transport infrastructure such as bus stops.

412 We note that bus provision in London prior to the introduction of franchising was operated by a public body (London Transport) whereas in the reference area bus provision is provided by commercial operators. In addition, we note that in Europe franchising has also been introduced in areas where previously bus provision had been operated by public rather than commercial entities.
timescale over which franchising might be expected to deliver improvements in outcomes.

- **Impact of area-wide franchising on market outcomes**

15.447 Next we considered the potential impact of area-based franchising on market outcomes (see Appendix 15.6, paragraphs 77 to 109). The impact of area-based franchising on market outcomes is potentially relevant both to our assessment of the likely effectiveness of franchising in addressing customer detriment and our assessment of its likely costs, and hence its proportionality. We received contrasting submissions on this issue from LTAs and operators. To help provide some perspective on these submissions, we also reviewed the evidence of the operation of franchising in London (see Appendix 15.6, Annex B). We looked at the available evidence, both positive and negative, on the following market outcomes:

(a) network efficiency (see Appendix 15.6 paragraphs 78 to 87);

(b) costs (see Appendix 15.6, paragraphs 88 to 96); and

(c) innovation (see Appendix 15.6, paragraphs 97 to 99).

15.448 We found that area-wide franchising has the potential to deliver improved customer outcomes through the ability of an LTA to deliver services such as integrated ticketing and fare structures across an entire network. Franchising can also lead to greater stability within a network and facilitate effective intermodal connectivity in complex multimodal networks. In addition, it can provide wider socio-economic and environmental benefits through the LTA’s ability to take account of externalities when planning the network.

15.449 However, we also concluded that franchising has a number of potential disadvantages. These include: the lack of direct contact between the LTA and the passenger which may reduce the responsiveness of the network to changes in passenger demand (although we were told that this may be less of an issue in PTE areas because of their interactions with passengers in areas such as coordinating customer complaints on behalf of operators); the most efficient operator not winning the contract, for example because of incumbency advantages; the network itself being inefficiently specified; and the potential for market distortions between inter- and intra-urban services.

15.450 There are several classes of additional costs that may be incurred through introducing area-based franchising:

(a) LTAs are likely to incur set-up costs and additional running costs associated with operating the franchise regimes (such as network planning and design). The PTEs currently looking at introducing franchising estimated initial set-up costs for a QCS up to £1 million and the additional running costs for each scheme at below £1 million a year. Research by TAS in 2003 suggested that annual costs for a PTE could lie within a range of £1–£5 million.413

(b) Operators may incur some extra costs associated with participating in the bidding process. The extent of these costs will be partly determined by the complexity of the tender process and the contract specification.

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413 TAS’s estimate did not take account of potential synergies within LTAs and TAS was not able to estimate a figure for individual PTEs based on their existing infrastructures.
Depending on the specification of the contract, some risks may be transferred from bus operators to the LTA and hence to the public sector. This is not necessarily a cost for the economy as a whole, but may be a relevant consideration for LTAs when considering whether to introduce area-based franchising.

15.451 Against this, LTAs may be able to achieve some savings in overall costs, both through network design and through reductions in operator returns, where these are currently above the cost of capital. Whether these savings are achievable, in practice, will depend on the extent to which the LTA is able to achieve competitive bids and optimize the specification of the network.

15.452 We considered whether franchising would have an adverse effect on innovation. Based on the available evidence, we concluded that, although it is plausible that franchising deters innovation, innovation can also be recognized in the contract selection process. In addition, by coordinating systems and specifying requirements of, for example, smart ticketing, authorities may be able to foster innovation that may not take place under a deregulated system.

15.453 The evidence we have seen on outcomes in the franchised London market is not conclusive due to the unique set of circumstances that has underpinned passenger growth in London in the last ten years. We noted that the franchising model has enabled TfL to introduce innovations such as the Oyster card and to implement various social and economic policies which are beyond our remit. We also noted that the level of subsidy in London was substantially higher than that observed elsewhere in Great Britain.

15.454 We concluded that, compared with the current deregulated market, area-wide franchising has the potential to address customer detriment and improve market outcomes in some circumstances, but that it is also likely to increase costs. An important determinant of the likely balance between costs and benefits is the extent to which the LTA is able to overcome the practical challenges associated with moving to a franchising model and thereby achieve an effective contract specification and vigorous competition for the franchise.

- Comparison of area-wide franchising with our remedy package

15.455 We concluded that area-wide franchising has the potential, in principle, to reduce the detrimental effect on customers that we have identified.

15.456 However, in order to achieve this, we note that area-based franchising would not directly address the AEC and would reduce or remove the scope for competition from the franchised area. Our preference, in relation to local bus services, is for remedies that provide the basis for effective and sustained competition ‘in the market’ compared with those that promote competition ‘for the market’. Remedies that promote competition ‘in the market’, if effective, would provide a strong basis for ongoing rivalry and commercial innovation in relation to all aspects of bus operators’ offer, including the dynamic benefits associated with new entry. In our judgement, these benefits would not be achievable with area-based franchising.

15.457 In addition, in light of the practical challenges associated with introducing area-based franchising and hence the risk to its effectiveness as a remedy, we took the view that area-based franchising was unlikely to be more effective than our package of remedies in addressing customer detriment, or to deliver results more rapidly.

15.458 We decided that area-based franchising was significantly more onerous than our package of remedies, both in terms of the implementation costs and, in particular, the
restriction on commercial freedom and the economic interests of existing operators, both large and small.

15.459 We also noted that some of the potential benefits of area-wide franchising—for example, network integration and integrated ticketing—are capable of being delivered within a deregulated market and would be enhanced by elements of our remedy package, particularly those relating to ticketing and partnerships.

15.460 We concluded that the package of remedies set out in paragraphs 15.9 to 15.428 directly addresses the AEC, is at least as effective in addressing the customer detriment and is less onerous than area-wide franchising. It therefore provides a more proportionate solution to the AEC. As a result, we have decided not to recommend area-wide franchising as a remedy to the AEC that we have found.

Selective or temporary franchising as a market-opening measure

15.461 Next we considered whether selective or temporary franchising could be used as a market-opening measure (see Appendix 15.6, paragraphs 110 to 121).

15.462 Selective franchising would involve an LTA issuing a competitive tender for the exclusive right to run local bus services on a limited subset of routes in an area, while allowing competition to take place on other routes within the area. Temporary franchising would involve an LTA issuing a competitive tender for the exclusive right to run bus services on some or all routes within an area for a limited period, after which competition would be permitted on the previously franchised routes.

15.463 We are not aware of any LTAs that are currently considering selective or temporary franchising. We discuss in Appendix 15.5 the actions that LTAs can take in developing and retaining a competitive market for tendering for supported services and, as a consequence, for local bus services. A number of respondents also noted that, in some rural areas, LTAs could and did tender almost all the services that were operated and that this effectively amounted to a form of franchising. Selective or temporary franchising could go further than this in two ways:

(a) by including commercially viable routes within the scope of the contract; and/or

(b) by restricting the ability of other operators to run services on the franchised routes.

- Impact of selective or temporary franchising on AEC and/or detriment

15.464 Selective or temporary franchising could contribute to addressing the AEC in local bus markets by providing the operator to whom a franchise was awarded with an opportunity to achieve critical mass and thereby provide a basis to compete with operators near to the franchised routes. This could increase the scope for potential competition on the non-franchised routes, which in time could develop into actual competition. With temporary franchising, at the end of the franchise period, there may also be scope for potential and/or actual competition on the franchised routes. As such, this option might be regarded as a type of market-opening measure; albeit one that involves a reduction of competition, on a transitional basis, in relation to the franchised routes.

15.465 Selective or temporary franchising is unlikely to be sufficient in itself to address the AEC, as the scope for potential competition would not necessarily translate into an increased competitive constraint, unless the other barriers to competition that we
have were also effectively addressed. We therefore concluded that, if we were to propose selective or temporary franchising, this would be alongside other measures, rather than instead of them.

- **Practicability of selective or temporary franchising**

15.466 Selective or temporary franchising faces similar issues in terms of practicability to area-wide franchising (see paragraphs 15.443 to 15.446). In addition, LTAs would need to consider which routes out of a network to put into the franchise and the likely commercial impact on the network of those operators which are currently operating the routes in question.

- **Impact of selective or temporary franchising on market outcomes**

15.467 In terms of market outcomes, selective or temporary franchising would have the potential benefit, relative to area-wide franchising, of allowing competition to take place outside the franchised routes. It would not, by itself deliver benefits in terms of network integration or integrated ticketing, and would have to be accompanied by other measures to deliver such benefits. There are also additional risks, relative to area-wide franchising, of creating distortions as a result of asymmetries in the competitive position between the franchise operator and nearby commercial operators.

- **Conclusion on selective or temporary franchising**

15.468 Based on the above assessment, we concluded that selective or temporary franchising was a relatively high-risk remedy, both in terms of the uncertainty associated with its effectiveness and the potential distortions that could arise. As a result, we decided not to include selective or temporary franchising within our package of remedies.

**Conclusion on franchising**

15.469 For the reasons set out in paragraphs 15.434 to 15.468 above, we have decided not to pursue franchising as a remedy option to the AEC and/or customer detriment that we have found.

15.470 However, we recognize that existing legislation enables LTAs to introduce franchising in England, Wales and Scotland and we would not wish to rule out its future application in particular local markets where the respective legislative requirements are met. In this regard, we also note that LTAs have wider social and policy objectives that are not relevant to this investigation, but which may legitimately lead them to take a different view on the desirability of introducing franchising in relation to the local bus markets for which they are accountable.

**Regulatory accounting**

15.471 In its response to the Remedies Notice, the DfT told us that it would be interested in the CC’s views on whether bus operators should be required to provide information akin to regulatory accounts,\(^414\) ie standardized accounts similar to those used for the regulated industry. These would provide a clear definition of the assets and capital base so it would be easier to estimate the weighted average cost of capital and profitability on a consistent basis.

\(^{414}\) DfT response to Remedies Notice, paragraph 16.
15.472 The DfT told us that it had some concerns that differences in profitability estimates based on publicly available information (e.g., the report it commissioned from LEK) and those based on more detailed information by the CC may reflect a lack of transparency within the bus industry’s accounts.

15.473 The DfT noted that there was an argument that bus industry accounts should be transparent because of the large amounts of public expenditure invested in the sector. There could ultimately be customer benefits if better knowledge of industry long-term profitability informed policy and led to a clearer pass-through of public expenditure to passengers in the form of cheaper fares and/or higher quality services. The DfT also considered that greater transparency might also help detect certain anticompetitive behaviour, such as unfair cross-subsidization, and might help potential entrants assess likely profitability of the market more accurately.

15.474 Some of the PTEs expressed support for proposals to increase transparency in bus industry accounts. For example, Nexus said that a clearer statement on the profitability of a network or area may encourage new entrants to that area and would allow a greater understanding of the application of public funds. PTEG also stated that some form of regulatory accounting would discourage predatory pricing and hence reduce barriers to entry. TfGM also said that regulatory accounting would address one of the main obstacles to effective partnership working, in that giving LTAs a sense of actual profitability would enable them to drive harder partnership arrangements with those operators making excess profits.

15.475 We noted the DfT’s views about the potential benefits to public policy that might arise if bus operators provided transport authorities with transparent and standardized accounting information and the views from some PTEs in support of this remedy. However, we were not persuaded that the publication of such information would remove or reduce barriers to entry or address any other aspect of the AEC that we have found. We therefore decided not to pursue this.

Divestiture and price controls

15.476 In paragraphs 75 to 78 of the Remedies Notice, we set out the reasons why we were not minded to pursue divestitures of local operations or direct controls on outcomes as remedy options. We did not receive any submissions advocating either of these options and we therefore did not pursue them further.

Prohibitions on ownership or management of bus stations

15.477 As a potential alternative to measures to enhance access to bus stations on FRND terms, we stated in the Remedies Notice that we may also consider more structural approaches, including:

(a) a prohibition on the management of privately-owned bus stations by bus operators that use the bus station in question; and/or
(b) a prohibition on the ownership of bus stations by bus operators that use the bus station in question.419

15.478 The Large Operators all told us that this was a disproportionate remedy. Some parties expressed concerns that it would be difficult to find buyers and the current budgetary constraints affecting LTAs were also raised as an issue. Go-Ahead commented that the bus owner might not have the same type of interest in the management of the station.420

15.479 Some parties considered, by contrast, that local bus operators should be prohibited from owning/managing local bus stations because, in their view, FRND rules would be ineffective.421 Another party (JMP Consultants) stated that the management and control of bus stations was usually best placed with local authorities, as they had an interest in the fair and effective access to bus-related infrastructure.422 We also received representations from Rotala, [Bus Operator A] and WAWCC that local bus operators should not be allowed to manage bus stations.423

15.480 Based on our assessment in paragraphs 15.222 to 15.290, we have decided that it is possible to specify a sufficiently robust and effective set of FRND bus station access obligations. As such, we have decided not to consider further these alternative remedies, which in our judgement would be significantly more onerous.

Restrictions on pricing behaviour

15.481 We identified a number of possible measures in the Remedies Notice (paragraphs 37 to 39) to facilitate the OFT’s ability to monitor bus pricing behaviour and thereby identify possible breaches of the 1998 Act for investigation. These included the mandatory reporting of ‘substantial’ price reductions by operators to the OFT, a wider role for the Traffic Commissioner in bringing pricing behaviour to OFT’s attention, and the preclusion of certain types of pricing behaviour in the wider Code of Conduct.

15.482 We received a range of views on this remedy option. Several larger operators told us that there was no evidence that the OFT was not both identifying and, where it thought appropriate, investigating breaches of the 1998 Act and that it had sufficient powers.424

15.483 There were few suggestions from parties as to what a ‘substantial’ reduction in price was.425 This was said to vary depending on local circumstances.426 There were also concerns expressed about the ability of the OFT to review a large volume of price changes.427 No issues were envisaged with the Traffic Commissioners bringing appropriate matters to the attention of the OFT, as is current practice, but for reasons of resourcing and skills (consistent with the analysis in paragraphs 15.116 to 15.125) there was little support for any wider investigatory duties for Traffic Commissioners in

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419 Remedies Notice, paragraph 47.
420 Go-Ahead response hearing summary, paragraph 23.
424 For example, Arriva response to Remedies Notice, p30; Stagecoach response to Remedies Notice, p26.
425 SPT told us that the threshold could be in the range of 10 to 30 per cent (response to Remedies Notice, p14) and the OFT told us that it might be very difficult to create a ‘bright line’ test to identify the trigger for bringing cases to its attention.
426 For example, National Express response to Remedies Notice, p5; Nexus response to Remedies Notice, p12; and Rotala response to Remedies Notice, p12.
427 For example, Lothian Buses response to Remedies Notice, p22; National Express response to Remedies Notice, pp19 & 20.
General pricing principles including, for example, the requirement to offer price changes over an operating area, rather than a route, were said to be distortionary.\textsuperscript{429}

15.484 We have decided not to take forward these remedy options because:

\textbf{(a)} We agreed with the concerns raised in paragraph 15.483 about the imposition of a mandatory price reporting requirement, taking into account the difficulties of setting an appropriate threshold for reporting.

\textbf{(b)} As a result, we took the view that the obligation to disclose information about price changes to the OFT would add additional regulation and related costs to business and the potential for the distortion of business decisions with little identifiable benefit.

\textbf{(c)} We decided that it would not be appropriate for Traffic Commissioners to expand their role in this area for reasons of resourcing and skills but that, if they were to receive pertinent information or complaints about pricing, then they would be able to alert the OFT as they would be expected to do in the current regulatory framework.

\textbf{(d)} We found that it would not be realistic to include any tailored rules in the Code of Conduct as these would be complex and would be difficult to specify (see paragraphs 15.122 to 15.125).

\textit{Relevant customer benefits}

15.485 In deciding the question of remedies, the CC may also in particular ‘have regard to the effect of any action on any relevant customer benefits of the feature or features of the market concerned’.\textsuperscript{430}

15.486 RCBs are limited to benefits to relevant customers in the form of:\textsuperscript{431}

\textbf{(a)} lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or

\textbf{(b)} greater innovation in relation to such goods or services.

15.487 The Act provides that a benefit is only an RCB if the CC believes that:

\textbf{(a)} the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and

\textbf{(b)} the benefit was, or is, unlikely to accrue without the feature or features concerned.\textsuperscript{432}

\textsuperscript{428} For example, Deputy Traffic Commissioner; Go-Ahead response to Remedies Notice, p10; Lothian Buses response to Remedies Notice, p22.

\textsuperscript{429} For example, Go-Ahead response to Remedies Notice, p10.

\textsuperscript{430} 2002 Act, section 134(7).

\textsuperscript{431} 2002 Act, section 134(8)(a).

\textsuperscript{432} 2002 Act, section 134(8)(b).
15.488 We have considered whether there are any RCBs which we should take account of in formulating our remedies.

15.489 In some previous merger investigations relating to buses, the CC has recognized RCBs associated with factors such as network effects, comprehensive network coverage, integrated ticketing and, in some circumstances, integrated timetables.433

15.490 However, none of these merger-specific RCBs derive from the features that we have identified as giving rise to the AEC in this investigation. This is because customers can enjoy these advantages in the absence of the features relating to high concentration, barriers to entry and customer conduct that we have identified as giving rise to the AEC. Moreover, the development of effective multi-operator ticketing schemes (as we have recommended in Figure 15.1 in paragraph 15.11) would enable customers to benefit from integrated ticketing and the associated ability to use a single ticket to access a network of services while at the same timeremedying the high levels of market concentration and barriers to entry associated with network strength and other incumbency advantages. Similarly, where the benefits of integrated time-tabling, for example, on particular high-frequency corridors, is in the public interest, this can be introduced by means of partnerships which would allow operators to continue to compete on other aspects of their offer (see Figure 15.6 and paragraph 15.400). As these merger-specific RCBs do not arise from the features giving rise to the AEC, they are not a factor to which we should have regard in this market investigation.

15.491 In our Notice of possible remedies, we asked for respondents to identify any RCBs. We received one submission from a party identifying a potential RCB. Lothian Buses argued that a certain critical mass was necessary to enable an operator to offer customers a comprehensive choice of destinations. For Lothian Buses, that critical mass was necessary to the delivery of its ‘social dividend’ as a municipal operator.434 Lothian Buses argued that its ability to constrain the prices of the large operators who compete with it in the Greater Edinburgh area was dependent on [ ]. If that [ ] was removed, because the CC’s remedies relating to multi-operator ticketing would artificially restrict the price of multi-operator tickets, [ ] then [ ].435

15.492 We note that Lothian Buses’ ability to offer customers a comprehensive choice of destinations provides it with a potential source of competitive advantage in the Edinburgh area and that, as a municipal operator, its strategy in relation to matters such as pricing or service quality may differ from privately-owned operators.436 However, we do not consider that high concentration and barriers to entry relating to network effects are necessary to achieving either low prices or comprehensive network coverage in the Greater Edinburgh area. Rather, we consider that by removing barriers to entry and expansion, including through the introduction of a more effective multi-operator ticketing scheme in the Greater Edinburgh area,437 the implementation of our remedy package is likely to deliver increased, rather than reduced, benefits to customers in the Greater Edinburgh area. Our remedies in relation to ticketing, set out in Figure 15.1, do not preclude Lothian Buses from

433 For example, in the Stagecoach/Preston merger investigation, the CC found that benefits from integrated ticketing following the merger constituted an RCB, albeit not one that caused the CC to change its decision on remedies in that case. Stagecoach Group Plc/Preston Bus Limited merger inquiry: a report on the completed acquisition by Stagecoach Group plc of Preston Bus Limited, 11 November 2009. Likewise in the Stagecoach/Scottish Citylink merger inquiry, the CC found that some RCBs resulted from the joint venture, but decided nonetheless to implement a structural remedy to address the SLC that it had found. Stagecoach and Scottish Citylink: a report on the completed joint venture between Stagecoach Bus Holdings Limited and Braddell PLC in relation to megabus.com, Motorvator and Scottish Citylink, 23 October 2006.
434 Lothian Buses response to Remedies Notice, paragraph 170.
435 Lothian Buses response to provisional decision on remedies, paragraph 5.9.
436 See paragraphs 3.4 and 6.21–6.24.
437 For example, a scheme that develops the existing One Ticket scheme in line with the principles set out in Figure 15.1.
setting the price of its own single operator tickets. Rather, they establish a fair method for determining the price of a multi-operator travelcard. For the reasons set out in Appendix 15.2, paragraphs 66 to 76, we do not expect that this approach to pricing will harm operators’ incentives to offer low prices or comprehensive network coverage in the Greater Edinburgh area or elsewhere.

15.493 We did not identify any other RCBs that accrue as a result of the features that give rise to an AEC, nor were any other possible RCBs suggested to us by any other party.

15.494 We concluded that RCBs are not a factor to which we should have regard in evaluating our remedy package.

The package of remedies: effectiveness and proportionality

15.495 Our analysis of the options and the decisions set out in paragraphs 15.9 to 15.484 has led us to select the following package of remedies:

(a) recommendations to national governments, the OFT and LTAs in relation to ticketing summarized in Figure 15.1 in paragraph 15.11;

(b) recommendations to national governments and to Traffic Commissioners in relation to operator behaviour, summarized in Figure 15.2 in paragraph 15.110;

(c) the establishment by means of a CC Order of a framework to enable fair access to bus stations, summarized in Figure 15.3 in paragraph 15.222;

(d) recommendations to national governments and to LTAs in relation to supported services, summarized in Figure 15.4 in paragraph 15.291;

(e) recommendations to the OFT in relation to the application of competition law, summarized in Figure 15.5 in paragraph 15.340;

(f) recommendations to national governments, to LTAs and to the OFT in relation to partnerships, summarized in Figure 15.6 in paragraph 15.373; and

(g) a recommendation to the DfT to consider how its review of BSOG might be developed in a way that supported other remedies, summarized in Figure 15.7 in paragraph 15.423. This recommendation may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

15.496 In the remainder of this section we consider the following:

(a) First, we describe how the remedy package addresses the AEC and the resulting customer detriment which has been found (paragraphs 15.497 to 15.512).

(b) Second, we consider other factors relevant to the effectiveness of the package which includes our consideration of the extent to which the remedies are capable of effective implementation, monitoring and enforcement, the timescale over which remedies will take effect, the consistency with other regulations applicable to the bus industry and the coherence of the package of remedies. We also consider comments from parties about effectiveness (paragraphs 15.516 to 15.546).

(c) Third, we consider its proportionality (paragraphs 15.547 to 15.589).
How the remedy package addresses the AEC

15.497 We discussed the rationale for each element of the remedy package in paragraphs 15.9 to 15.428. In paragraphs 15.498 to 15.515, we set out how the elements in the remedy package work together to remedy the AEC and the resulting customer detriment that we have found. We look first at the contribution of each element of the remedy package to addressing the AEC. We then discuss the synergies between the elements of the remedy package and some important common themes.

Contribution of each element of the remedy package

15.498 The main focus of our remedy package in markets for commercial bus services is on three market-opening measures designed to reduce barriers to entry and, consequently, concentration. The outcome will be an environment in which competition is more likely to arise and to be sustained:

(a) The development of effective multi-operator ticketing schemes, following the recommendations in Figure 15.1, is a necessary and effective measure to address incumbency advantages arising from network strength and incumbents' consequent ability to offer more attractive multi-journey tickets than smaller operators. Final decisions about multi-operator ticket schemes will be taken locally in line with the principles set out in this report.

(b) The restrictions on operator behaviour that we have adopted are no more than we judge necessary and appropriate to address the barriers to entry and expansion associated with sunk costs of entry, cheap exclusion and the expected intensity of post-entry competition and to increase the likelihood of head-to-head competition being sustained. Having considered a range of options, and as summarized in Figure 15.2, we have concluded that the most practicable and proportionate way to address these problems is by changing the registration process, development of a Code of Conduct on cheap exclusion and some small but important protections for municipal operators undergoing a sales process.

(c) To address the barriers to entry associated with access to bus stations, we have decided that a framework to regulate access so that third party operators have fair access to a bus station managed by a competitor is necessary. A fair access framework as summarized in Figure 15.3 will enable third party operators to compete on a level playing field and give confidence to potential entrants that their entry plans are not at risk by difficulties in securing access to bus stations.

15.499 Taken together, these market-opening measures will significantly reduce the main barriers to entry and expansion that we have found. They will consequently reduce market concentration and increase the constraint imposed by potential competition. Moreover, by reducing barriers to entry and expansion, we expect it to become harder for operators to sustain a coordinated outcome and, as a result, the incentive to coordinate will also reduce. We expect this combination of market-opening measures to increase the likelihood of entry and expansion and result in a sustained increase in competition.

15.500 In relation to supported services, the development and enhancement of best practice guidance as set out in Figure 15.4 will reduce the risk that tenders are specified in ways that restrict competition. Enabling LTAs to require information about newly deregistered services from operators will enhance LTAs’ ability to specify and manage the tenders to promote competitive outcomes and will reduce the risk of competition being restricted by incumbency advantages.
15.501 We have recommended changes to the wider regulatory and policy environment as part of our remedy package.

15.502 It is essential that the opportunity for increased competition presented by our remedy package should not be lost as a result of mergers, anticompetitive agreements or the type of predatory behaviour seen in bus markets during the period immediately following deregulation. It is critically important that the Chapter I and Chapter II prohibitions deter illegal agreements and exclusionary behaviour by dominant operators. Vigilant merger control is necessary to prevent further increases in market concentration. We therefore see a key role for the CC and OFT to enforce competition law to address the AEC and limit the scope for further increases in market concentration. We have made recommendations to this end in Figure 15.5. We similarly expect our Code of Conduct (see Figure 15.2) to strengthen the role of Traffic Commissioners in ensuring that increased rivalry is not accompanied by ‘cheap exclusion’. To maximize the beneficial effects of our remedies, it will be important that the enforcement of competition law and the regulatory functions of the Traffic Commissioners in the bus industry are accorded a high priority by the agencies involved and the bodies that fund them.

15.503 Carefully designed and implemented partnerships between LTAs and operators can also contribute to remedying the AEC. Partnerships between LTAs and bus operators can provide an opportunity to grow bus markets through mutually supportive investment, stimulating competition among bus operators. An important objective of such investment is the provision of accurate information about bus services to passengers. Such investment can provide a supportive environment for both new entry and ongoing rivalry. Well-designed partnerships may also be used as a basis for sustained competition. However, we are also mindful of the risks of misuse of partnerships and the importance of proper scrutiny of their effects on competition. To this end, we have recommended the creation of a forum in which the OFT, LTAs and other stakeholders can discuss the practical aspects of evaluating their competitive impact. Our recommendations in relation to partnerships are set out in Figure 15.6. Decisions in relation to partnerships are inherently local in nature and are ultimately for the LTA to take, subject to careful scrutiny of proposals by reference to the relevant competition test.

15.504 Finally, we have made some recommendations to the DfT, summarized in Figure 15.7, to use its current review of BSOG to promote behaviour and investments that support competition. These recommendations may also be of interest to the Scottish and Welsh Governments, should they decide to undertake a similar review.

Synergies and common themes

15.505 There are important synergies within our remedy package and some common themes.

15.506 First, the measures that will reduce barriers to entry and expansion, such as the ticketing remedies in Figure 15.1, complement the remedies that promote sustainable competition, such as those relating to operator behaviour in Figure 15.2. The impact of measures to reduce barriers to entry and expansion will be more effective in delivering better outcomes for passengers if that entry or expansion will be sustained and will provide a long-term competitive constraint.

15.507 Secondly, the remedies aimed at the wider regulatory and policy environment (see paragraphs 15.501 to 15.504) complement the market-opening measures summarized in paragraph 15.498.
15.508 In particular, information and transparency has a major role to play in delivering competitive outcomes in markets for bus services. Passengers need to be aware of their ticketing options and, in particular, multi-operator tickets must be adequately promoted if they are to be effective. When catching a bus at a privately-managed bus station, information about all services, not solely those run by the owner or manager of the station, should be easily available to passengers. Partnerships between operators and LTAs can provide a framework for the investments needed to deliver real time information to passengers, reducing waiting times (or their perception) and enabling passengers to make an informed choice about whether to catch the first bus or wait for an alternative. Transparency about the revenues and passenger flows on supported and deregistered services will enable LTAs to make better informed decisions about how to specify tenders in ways that secure the best value for money for the taxpayer.

15.509 In response to our provisional decision on remedies, the DfT told us that it believed that fares information was a key factor in enabling passengers to distinguish between competing services on price. It therefore intended to seek some expert advice shortly on what might be an appropriate form for gathering and presenting fares information to passengers, without inhibiting an operator’s flexibility to change its fares.438 We welcome the DfT’s initiative, which is consistent with the importance that we have placed on passenger information in our remedy package.

15.510 Thirdly, although we have identified distinct remedies for commercial and tendered local bus services, we recognize the connection between these two aspects of bus markets. A competitive market for local bus services provides a pool of operators to bid for supported services and may reduce the need for services to be supported, where entrants are prepared to run services that are unattractive to incumbents. Likewise, imaginative approaches to tendering supported services is an important way in which LTAs can positively influence the competitive environment within their local area (see Appendix 15.5).

15.511 Fourthly, while we have identified remedies that are potentially broad in geographic scope, many of them are capable of being tailored at a local level and according to local conditions. This is particularly the case for the remedies relating to ticketing, supported services and partnerships, for which final decisions relating to local implementation of our recommendations will need to be taken at a local level. We have sought to reflect differences between nations (ie England, Scotland and Wales) in our remedies that relate to devolved matters. LTAs will have important roles to play in the specification and delivery of improvements to ticketing schemes, developing partnerships with operators, acting as a first port of call for disputes in relation to bus station access and in securing competitive outcomes for tenders to run supported services.

15.512 Fifthly, in the selection and design of remedies, we have been particularly mindful of the need to ensure that we do not increase the likelihood of geographic market segregation, or of other forms of coordination between operators that would adversely affect competition and/or harm the interests of bus passengers (see paragraphs 8.166 to 8.262). This consideration has shaped the design of our remedies in a number of ways. For example, we have recommended that in introducing partnerships and applying the relevant competition test, LTAs are careful to take account of the risks associated with facilitating coordination between competitors in so far as that exceeds what is lawful and necessary to deliver passenger benefits (see Figure 15.6). Likewise, in relation to our ticketing remedies, we have decided not to recommend that price setting be permitted on route-based ticketing schemes because of

438 DfT response to Remedies Notice, paragraphs 34 & 35.
the risk that agreement on the price of a multi-operator ticket could result in the removal of price competition on the route (see paragraph 15.64).

Conclusion on how the remedy package addresses the AEC

15.513 By addressing the main causes of the AEC, we expect our remedy package to result in a substantially improved environment for competition in local bus markets.

15.514 We expect the package of remedies to result in increased head-to-head competition and an increased constraint from potential competition across the reference area. As a result of these increased competitive constraints, we expect a substantial improvement in outcomes for consumers.

15.515 We see important synergies between those elements of the package that create further opportunities for entry and expansion and the development of a policy and regulatory framework in which such increased opportunities for competition are more likely to be sustained. We also see important synergies between measures to remedy the AEC in relation to local bus services and the measures to remedy the AEC in relation to tendering of supported services.

Other factors relevant to our consideration of effectiveness

15.516 For the reasons set out above, we conclude that this remedy package will target the underlying causes of the AEC. In evaluating the effectiveness of our remedy package, we have considered the following further factors:

(a) the extent to which the remedies are capable of effective implementation, monitoring and enforcement (paragraphs 15.517 to 15.522);

(b) the timescale over which remedies will take effect (paragraphs 15.523 to 15.532);

(c) consistency with other regulations applicable to the bus industry (paragraphs 15.533 and 15.534);

(d) coherence as a package of remedies (paragraphs 15.535 to 15.537); and

(e) other submissions we received on the effectiveness of the remedy package (paragraphs 15.538 to 15.545).

Implementation, monitoring and enforcement

15.517 In developing each remedy, we have considered how it could best be implemented, monitored and enforced.439

15.518 The majority of our remedies are recommendations. We have had constructive discussions with the DfT and the Scottish and Welsh Governments and with other parties on whom the task of implementation will fall. The DfT broadly welcomed our provisional decision on remedies. LTAs and PTEs were particularly supportive of our

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439 See in particular paragraphs 15.83 to 15.109 (ticketing), 15.214 to 15.221 (operator behaviour), 15.278 to 15.290 (bus station access), 15.334 to 15.339 (supported services), 15.420 to 15.422 (partnerships). There is no equivalent subsection in relation to effective competition enforcement and compliance or BSOG, which recommendations are clearly directed to the OFT and DfT respectively.
remedies relating to ticketing. Where we are taking action ourselves, the remedy is clearly capable of effective implementation under the CC’s Order-making powers.  

15.519 Wherever possible, we have sought to make use of existing enforcement mechanisms and agencies, including the OFT and Traffic Commissioners. We have also had regard to the role that LTAs can play in delivering the outcomes we seek through our remedies. We have been sensitive to the financial constraints currently facing public sector bodies and have sought to ensure that any additional responsibilities should be manageable.

15.520 In response to our provisional decision on remedies, Nexus expressed some concerns regarding the successful delivery of the package of remedies and what it described as ‘enforcement deficiencies’. It told us that the majority of our remedies would require legislative change and questioned the potential of voluntary delivery by operators without the presence of a financial incentive or benefit. Nexus told us that this concern was compounded by the commitment and resources required from those agencies who had responsibility to deliver the package.

15.521 Some of our remedies will require legislative change to have full effect. We have identified non-legislative interim actions that may be taken in relation to ticketing (see paragraph 15.108), the Code of Conduct (see paragraph 15.220) and supported services (see paragraph 15.339), where we acknowledge that legislation may take time (see paragraph 15.526). Similarly, we acknowledge that the delivery of our remedies will require the participation and cooperation of bus operators. Such cooperation is both inevitable and desirable given the need for LTAs and operators to work together to deliver good outcomes for bus passengers. Our recommendations in relation to BSOG (see Figure 15.7) are aimed, in part, at providing suitable incentives for operators to act in ways that will promote competition and thereby improve outcomes for customers. We also agree with Nexus that the commitment of LTAs will be essential to effective change and have been mindful of the current funding environment in developing our remedies. Overall, while we agree with Nexus that—as with any change—successful implementation cannot be taken for granted, we do not agree that there are deficiencies in the enforceability of the package of remedies that we have identified.

15.522 Consequently, and in light of our detailed assessment of the implementation of each remedy option, we conclude that each of our remedies is capable of effective implementation, monitoring and enforcement.

Timescale over which remedies will take effect

15.523 In considering the timescale over which our remedies will take effect, we considered both the time to implement them and the time, once implemented, for the remedies to take effect.

15.524 The CC would normally expect to make an Order within a period of around six to nine months following publication of a final report. We would expect to be able to make an Order in relation to access to bus stations within this timescale.

15.525 As to our recommendations to others, the timing of implementation will be for those bodies to determine in line with their own priorities. In our judgement, our remedies

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440 Schedule 8 of the 2002 Act. Our reasons for implementing this remedy by means of an Order are set out in paragraph 15.284.

441 Nexus response to provisional decision on remedies, paragraphs 1.2 & 11.2.
are important measures that will deliver significant benefits to passengers and we therefore recommend their prompt implementation. Nonetheless, these timescales are not in our control.

15.526 It will also be a matter for the bodies to which we have made recommendations to determine how such recommendations could best be implemented. The means by which our recommendations are implemented, and the associated timescale, is likely to vary by remedy:

(a) Primary legislation may be required to implement some of our measures, for example some aspects of the remedies in relation to ticketing, operator behaviour and supported services. In response to the provisional decision on remedies, the DfT told us that it did not expect new primary legislation to be a short-term option and that our initial assessment that it could take two to three years to implement new primary legislation ‘may be ambitious’, given the current substantial legislative programme.\(^{442}\) PTEG similarly emphasized the potential timescales associated with introducing new primary legislation.\(^{443}\) We believe that it is reasonable to anticipate a timescale of between two and four years for the implementation of primary legislation, though we acknowledge that implementation of our remedies would need to be accorded a high priority for new primary legislation to be given effect within the first half of this range. In order to deliver some of the benefits of these remedies more quickly, we have also identified non-legislative, interim actions that may be taken where we expect the necessary legislation may take time to implement (see paragraph 15.521).

(b) Some of the legislative changes that we have recommended can be achieved through secondary legislation. This applies, in particular, to the changes to notice periods that form part of our remedies in relation to operator behaviour. The DfT told us that it would expect to be able to implement secondary legislation more quickly, subject to the Government’s commitment to minimizing regulatory burdens on business.\(^{444}\) In light of these comments, we would expect that changes requiring secondary legislation could be implemented within a period of no more than one to two years.

(c) Other recommendations (e.g. the best practice guidance in relation to tendering for supported services and our recommendations in relation to effective competition enforcement, partnerships and BSOG) do not require new legislation. The DfT told us that it expected to announce the outcome of the review of BSOG, and the proposed way forward, by March 2012. Where we have recommended the development of new guidance, a review of existing guidance, or the establishment of a forum, either as a main remedy or as an interim solution, we would expect these processes to be deliverable within a period of no more than one to two years.

15.527 We therefore conclude that, subject to the necessary commitment on behalf of the bodies to which we have addressed our recommendations, each element of our remedy package is capable of being implemented within a period of no more than two to four years following our final report. We would expect a number of elements of the remedy package to be in place more quickly.

15.528 A number of factors will affect the period in which our remedies will have their effect.

\(^{442}\) DfT response to provisional decision on remedies, paragraphs 7 & 17.
\(^{443}\) PTEG response to provisional decision on remedies, Annex A.
\(^{444}\) DfT response to provisional decision on remedies, paragraph 7. The DfT noted also that it would be required to identify regulatory savings elsewhere to offset any costs that may be borne by bus operators as a result of the changes.
We expect operator behaviour and market outcomes to change in anticipation of the formal legislative changes. In particular, there is little in the current regulatory framework to inhibit operators from working together with LTAs to develop and reform ticketing schemes in line with the principles set out in Figure 15.1. We have recommended to LTAs that they pursue such reform with operators pending the legislative change that we have recommended and we have made interim recommendations to national governments to take actions to support LTAs in seeking to effect such reform. Some LTAs are already taking steps to reform ticketing schemes in line with the principles set out in our provisional decision on remedies (see paragraph 15.86) and we warmly welcome these initiatives. We also expect those more forward-looking operators to work with LTAs to take the necessary actions in advance of the extension of LTA powers that we have recommended, particularly if such behaviour is incentivized by changes to BSOG (see Figure 15.7).

Once our remedies have been implemented, we expect them to have an immediate impact on the incentives of existing operators and potential entrants. In particular, we expect an increased threat of competition from potential competitors and new entrants to have an immediate effect on incentives and behaviour and that resulting increases in head-to-head competition would be sustainable. Where operators have responded to a heightened threat of competition (see paragraphs 6.62 to 6.72) or to new entry (see paragraphs 6.105 to 6.142), they have done so relatively quickly. We note that some operators keep important aspects of their service offering, such as service frequency, under constant review. Changes to such aspects of service offering can be made within a period of four to six months.445

We expect this change in incentives and behaviour to be translated into substantial improvements in market outcomes within one to two years of implementation as operators, including new entrants, seek to take advantage of competitive opportunities as they arise and as incumbents look to improve their offering in light of the increased competitive constraints. As noted in paragraph 15.529, some operators and LTAs might take action in anticipation of implementation of formal legislative changes. We expect these improvements in market outcomes to be sustained.

Based on the considerations set out in paragraphs 15.523 to 15.530, we conclude that our remedies should be fully implemented with a substantial impact on the AEC and resultant customer detriment within three to six years of publication of our final report. We have based this range on our assessment that each element of the remedy package is capable of being implemented within a period of no more than two to four years (see paragraph 15.527), and that changes in incentives and behaviour may be expected to translate into substantial improvements in market outcomes within one to two years of implementation (see paragraph 15.531). We expect some significant beneficial effects to arise earlier. We are not aware of any other effective and proportionate remedies that would deliver results in a shorter timescale than this.

Consistency with other regulations

Wherever possible, we have sought to build on the existing regulatory framework that applies in the bus industry. We have decided to introduce additional measures where there is a clear gap in the existing regulatory framework in relation to fair access to privately managed bus stations. In relation to the other measures, we have recommended ways in which the existing statutory framework can be operated, or incrementally amended, to address the specific problems identified in our investigation.

445 Paragraph 6.43.
15.534 We conclude that our remedy package is consistent with other regulations that apply to the bus industry.

Coherence as a package of remedies

15.535 We have considered whether the measures in the remedy package are likely to be mutually reinforcing.

15.536 In response to the provisional decision on remedies, SYPTEx said that our remedies package was not really a coordinated package, but more a series of individual measures.446

15.537 We do not agree. In our judgement, there are important synergies between the different elements of the remedy package (see paragraphs 15.506 to 15.510). It includes measures aimed at opening bus markets up to greater competition as well as providing an environment in which such competition will be sustained (see paragraph 15.506). There are also important synergies between increasing competition to supply local bus services and increasing competition in tendering for supported services (see paragraph 15.512).447 We conclude that the measures in our remedy package are mutually reinforcing and that the remedy package, taken as a whole, represents a coherent response to the competition problems that we have found.

Other submissions on the effectiveness of remedy package

15.538 While welcoming some of the measures in our provisional decision on remedies, PTEG and some PTEs believed that our remedy package was likely to be of limited effectiveness, particularly in relation to the large urban areas for which they were responsible.448 These parties also submitted that we had understated the benefits of franchising relative to our remedy package—see paragraphs 15.434 to 15.470.449 A number of reasons were given for these views:

(a) PTEG and some PTEs argued that there is little evidence to suggest that remedies that seek to increase the scope for head-to-head competition were likely to succeed and/or deliver customer benefits.450 For example, PTEG submitted that there is little evidence that head-to-head competition is currently uncommon in paragraphs 8.18 to 8.92. DfT statistics show that buses and coaches collectively account for around 1 per cent of motor vehicle traffic miles. As a consequence, while infrastructure constraints may be a relevant factor on some routes, we do not consider that it is likely that a material number of routes will be affected by limitations on infrastructure. We assess the reasons why head-to-head competition is currently uncommon in paragraphs 8.18 to 8.92. DfT statistics show that buses and coaches collectively account for around 1 per cent of motor vehicle traffic miles. As a consequence, while infrastructure constraints may be a relevant factor on some routes, we do not consider that it is likely that a material number of routes will be affected by limitations on infrastructure. We note that partnerships may be used to provide transparent and fair methods of managing scarce road capacity in busy city centres while facilitating competition to operate bus services within these cities (see paragraph 15.388(a)).
incentive for operators to maintain the status quo and avoid effective on-street competition (see also paragraph 15.389).  

(b) Some PTEs noted that some or all of our measures were in force already in the areas for which they had responsibility, but that there remained structural problems and/or customer detriment within these markets.

(c) PTEG and some PTEs argued that our package of remedies was incapable of dealing effectively with geographic market segregation.

15.539 We have considered each of these arguments carefully. We do not agree that head-to-head competition is undesirable or incapable of being sustained in a deregulated bus market. As set out in paragraphs 8.7 and 8.8, head-to-head competition, where present, delivers significant benefits for passengers. Our remedy package includes measures—for example, in relation to operator behaviour—that have been designed to increase the likelihood of sustained competition and which we judge will be effective in doing so.

15.540 Multi-operator ticketing schemes are in place in all the PTE areas and also other initiatives, such as partnerships, have also been introduced by PTEs. However, we have found that there is scope to improve the effectiveness of all existing ticketing schemes (see paragraph 15.37). By reforming existing ticketing schemes in line with our recommendations, we expect barriers to entry and expansion to be reduced in PTE areas and elsewhere. Likewise, we have found that there is scope to tailor partnerships to promote competition, and that this objective has been granted insufficient prominence to date. Overall, we believe that our package of remedies will add significantly to the impact of existing initiatives in promoting competition in PTE areas, as well as in other parts of the country.

15.541 Our assessment of the impact of our remedies on operators’ incentives and ability to coordinate (including through geographic market segregation) is set out in Appendix 15.7. By reducing barriers to entry and expansion—through the introduction of market-opening measures—we expect our remedies to make it harder for operators to sustain a coordinated outcome and to reduce incentives to coordinate. Likewise, several of our measures will increase the deterrent effect of competition law on illegal forms of coordination. This will be achieved through proactive and vigorous competition enforcement, combined with clear communication by the OFT of what forms of coordination are unacceptable (whether in a bilateral agreement between operators, or as part of a partnership) and the additional incentives provided by the Code of Conduct and our recommendations in relation to BSOG. Similarly, our recommendations in relation to merger control are likely to increase the risks of detection, where operators seek to package an agreement to coordinate as a qualifying merger.

15.542 When taken together as a package, these measures are likely to reduce both the ability and incentive of operators to coordinate in ways that harm customers’ interests.

15.543 Some Large Operators commented on the effectiveness of our remedy package. Arriva told us that our remedies would not address the fundamental issue facing the

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451 PTEG response to addendum to provisional findings on geographic market segregation and operator conduct, paragraphs 2.1–2.14.
452 Metro response to provisional decision on remedies, p1. Nexus response to addendum to provisional findings on geographic market segregation and operator conduct, paragraphs 1.4 & 2.5.
453 Response to addendum to provisional findings on geographic market segregation and operator conduct: Nexus, paragraphs 2.1–2.5; SYPTe, p1; PTEG, paragraphs 6.1–6.3; Metro, p1; TfGM, p3 & Appendix B.
local bus markets, namely falling demand. Stagecoach submitted that the CC had failed to evaluate adequately the effectiveness of the remedies in relation to ticketing and operator behaviour. In making this submission, it noted that the CC had not carried out route profitability analysis in relation to these or other remedies and could therefore not assess whether there would be unmet demand when the remedies were implemented, which a new entrant would be able to seek to exploit.

15.544 We do not agree with Arriva. Our duty in developing our remedy package has been to remedy the AEC that we have identified. In fulfilling this duty, we also expect our remedies to result in increased passenger usage of bus services, by delivering the benefits of a more competitive market, as well as other passenger benefits such as the convenience of using more attractive multi-operator tickets (see paragraphs 15.571 to 15.576).

15.545 Similarly, we do not agree with Stagecoach that we have failed to evaluate adequately the effectiveness of any of our remedies. We have given careful consideration to how our remedies are likely to address the AEC, both alone and in combination (see paragraphs 15.497 to 15.515). A detailed analysis of profitability at the route level was not practicable, given data limitations and the scale of the task. But we have developed our package with the extent of the overall detriment, and the fact that we do not have route-level profitability analysis, firmly in mind. Moreover, it is clear from the analysis in Appendix 11.4 that there are very many routes within the reference area in which head-to-head competition is feasible, but absent. In our judgement, there are many opportunities for effective competition that could be realized, by addressing the features that give rise to the AEC and the outcome of our analysis in Appendix 11.4 has informed our approach to remedies.

Conclusion on effectiveness of remedy package

15.546 In our view, the assessment in paragraphs 15.497 to 15.545 demonstrates that this package of measures will effectively remedy the AEC and, as a result, will substantially reduce the customer detriment that flows from it. We expect the remedy package to have a substantial impact on both the AEC and the resultant customer detriment within three to six years of publication of this report.

Evaluation of proportionality

15.547 Many of the matters that we have discussed in paragraphs 15.497 to 15.546, and in particular our extensive review both here and during the course of our investigation of the effectiveness of our remedies and of alternative remedies, go directly to proportionality.

15.548 In paragraphs 15.553 to 15.589 we state four key questions, and our approach to them, that have heavily influenced our approach to remedies. However, aside from the detailed analysis in those paragraphs, four broader considerations have had a pervasive influence on our choice of remedy and on our thinking about proportionality. In a matter as complex as the remedies for a nationwide inquiry into the markets for local bus services, it is worth stating them.

15.549 First, the limitations that we have identified in competition in local bus markets are significant and widespread shortcomings in an important market that customers rely upon. While the detriment that we have identified is not extreme in scale, it is cer-

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454 Arriva response to provisional decision on remedies, paragraph 1.1.
455 Stagecoach response to provisional decision on remedies, paragraphs 2.14–2.17.
tainly significant and more than justifies a remedy. Moreover the features that give rise to the AEC are deep-seated features of the market, have been for some time, and absent intervention will continue to be so. This is relevant both to our understanding of the extent of future detriment, should no action be taken, and to the importance of a remedy now.

15.550 Secondly, the markets in which there is an AEC are many and widespread, but they are not homogenous. This has meant that, where possible, we have looked for remedies that can be adapted to local circumstances. Where remedies lack that flexibility, and in particular where they impose obligations in markets where there is no AEC as well as those where there is, we have been particularly careful to satisfy ourselves that the advantages of the remedy where there is an AEC justify the burden of the remedy where there is not. This has been of particular concern to us in relation to our recommendation that registration periods be extended, which will affect competitive and anticompetitive registrations alike. Where it is possible and prudent to do so, we have recommended that LTAs and others with a continuing responsibility for and interest in local bus markets should implement remedies. Nonetheless, the fact that the AEC is widely dispersed across numerous markets has made it impractical to limit remedies to specific flows and routes, and this has had a significant effect on our thinking.

15.551 Thirdly, and to some extent in consequence, we have preferred less onerous measures that work with the grain of existing legal and regulatory controls rather than, for example, imposing changes to the pattern of bus depot and station ownership through divestments.

15.552 Fourthly, we believe that the features and AECs that we have identified are capable of manifesting themselves elsewhere within the reference area in future. Our remedies are forward looking in nature and are aimed at preventing future harm as well as addressing current problems.

15.553 We evaluated whether this package would be a proportionate response to the problems that we have identified by considering the following four key questions:

(a) Is the remedy package effective in achieving its aim (see paragraph 15.554)?

(b) Is the remedy package no more onerous than necessary to achieve its aim (see paragraphs 15.555 to 15.566)?

(c) Is the remedy package the least onerous if there is a choice (see paragraphs 15.567 and 15.568)?

(d) Does the remedy package produce adverse effects which are disproportionate to the aim (see paragraphs 15.569 to 15.588)?

Effective in achieving its legitimate aim

15.554 We concluded in paragraph 15.546 that this package of remedies would be effective in achieving the aim of remedying the AEC that we have found.

No more onerous than necessary

15.555 Each element of the remedy package is necessary in order to achieve as comprehensive a solution as is reasonable and practicable to the AEC. As set out in paragraphs 15.497 to 15.512, the remedy package comprises a set of complementary
measures, each of which makes a significant contribution to remedying the AEC by tackling one or more of the features giving rise to the AEC. We have not pursued options, such as restrictions on pricing behaviour or regulatory accounting, because we did not find that they would contribute materially to the effectiveness of the remedy package.

15.556 We have also taken care to ensure that the design of each element of the remedy package is no more onerous than necessary to remedy the AEC. For example, in relation to ticketing, we have chosen not to impose restrictions on single-operator multi-journey tickets, as we judged this to be more intrusive than necessary. Similarly, to address the barriers to entry associated with bus station access, we have chosen the less intrusive approach of developing a framework for fair access to bus stations, rather than requiring operators to divest existing facilities.

15.557 We have given careful consideration to the appropriate geographic scope of each remedy option. In doing so, we have had regard to a number of factors, including:

(a) the geographic extent of the AEC and of the specific aspect of the AEC to which the remedy option is directed;

(b) the extent to which it is practicable to restrict the geographic application of a particular remedy option, without compromising the effectiveness of the measures; and

(c) the reasonableness and proportionality of applying a remedy with a broader or narrower geographic scope.

15.558 We have also considered the role that local market participants, in particular LTAs, can play in determining the precise action to be taken in particular parts of the reference area. In most cases, these considerations have led us to prefer to implement our remedies by means of recommendations to government to amend legislation in ways that will enable LTAs and others to take action that will remedy the AEC, in light of relevant local considerations. Where we have decided to take action ourselves in relation to the provision of access to bus stations, we have decided to do so in a way that provides scope for issues to be resolved locally, within the framework that will be set out by the CC’s Order.

15.559 In response to the provisional decision on remedies, several parties argued that selecting a package of broadly applicable remedies would be disproportionate, as these measures would affect operators in markets in which there was no AEC.

15.560 In its response to our provisional decision on remedies, Stagecoach noted that we had proposed remedies in respect of markets which had no AEC and submitted that the CC was acting beyond its statutory powers in proposing remedies that would apply to areas which were not subject to an AEC. In support of this argument, Stagecoach noted that ‘Category 1’ routes accounted for more than 50 per cent of all routes in an area in less than 30 per cent of Urban Areas. It submitted that this implied that, according to the CC’s categorization, only 30 per cent of Urban Areas were highly likely to be subject to an AEC. Stagecoach argued that ‘in light of the narrow geographical spread of the AEC, it is abundantly clear that the application of

456 See paragraphs 15.433–15.484.
457 See Appendix 11.4 for a description of our route classification exercise. Category 1 routes do not face an overlap of 90 per cent and also do not face an overlap of 3.2 km or more. Routes in this category have also been identified as ‘not constrained by rail or tram’ using the filters set out in Appendix 11.2. It is therefore highly unlikely that these routes face meaningful head-to-head competition.
the Commission’s remedies to all geographic areas is ultra vires, as the remedies have no legal basis in the majority of Urban Areas (or, alternatively, are disproportionate).\footnote{Stagecoach response to provisional decision on remedies, paragraphs 2.1–2.10. For the reasons set out in Appendix 11.4, paragraph 13, we disagreed with Stagecoach’s suggestion that an AEC only arises where more than 50 per cent of routes in an Urban Area are in ‘Category 1’.}

15.561 Lothian Buses and NCT made similar arguments by specific reference to the Greater Edinburgh area and Nottingham respectively.\footnote{Lothian Buses noted that the CC had not suggested that implementation of remedies might be dependent on having identified a particular local market as exceeding specific thresholds relating to, for example, the market share of the largest operator(s) or the proportion of ‘Category 1’ routes within the market. Lothian Buses response to provisional decision on remedies, paragraphs 2.6 & 2.7. NCT submitted that, unless and until the CC made a finding of an AEC in the Nottingham local bus market, the CC was not legally in a position to impose remedies on that local market. NCT response to provisional decision on remedies, paragraph 1.1. See paragraphs 11.64 to 11.66 and Appendix 11.4 for our assessment of the geographic extent of the AEC.}

15.562 These submissions raise an important issue, and one that we had firmly in mind in thinking about remedies. We have, as far as is practicable, targeted our remedies at the causes of the AEC, using the evidence that we have of the geographic extent of different market features to guide our decisions as well as the practical issues associated with seeking to target particular areas. In doing so, we have sought to balance the risks of ‘over-enforcement’—for example, introducing remedial measures into markets where there is no AEC—and of ‘under-enforcement’—for example, failing to tackle problems effectively, where they do exist.

15.563 The implications of this approach for the appropriate geographic scope of the remedy have varied according to the particular remedy under consideration. For example, looking at the three market-opening measures:

\(a\) The introduction of effective multi-operator ticketing schemes is, in our view, a key element in removing barriers to entry and expansion which we have found are present, albeit in differing degrees, throughout the reference area (see paragraph 15.15). Multi-operator ticketing schemes do not yet exist in many areas (see paragraphs 15.30 and 15.31) and those that exist are limited in their effectiveness (see paragraph 15.37). Moreover, it is not practicable to exclude particular routes or flows from a multi-operator travelcard where the introduction of such a ticketing scheme would serve to reduce barriers to entry and expansion and increase competition. The broadly-based nature of this aspect of the AEC, combined with practical considerations, has led us to recommend changes to the legislative and competition law framework that applies to multi-operator ticketing schemes throughout the reference area. We have also found that the extent of network effects is likely to vary between routes and Urban Areas. We have presented information in Appendix 15.3, Table 1, including indicators from our route classification exercise in Appendix 11.4, which has shaped our recommendations to LTAs and will help LTAs to identify those areas where introduction of an effective MTC is particularly likely to be beneficial. Similarly our recommendations in relation to existing schemes have been guided by the evidence we have collected on those schemes in Appendices 9.2 and 15.2.

\(b\) In relation to the remedies regarding operator behaviour, we have given very careful consideration to whether a tailored approach to changes to service frequency was likely to be practicable (see paragraphs 15.114 to 15.127). We have concluded that it is not possible to limit this remedy only to routes where there is likely to be an AEC, and that the only practicable approach is to make generally
applicable changes to the nationally-determined rules that govern the registration of bus services (see paragraphs 15.125 to 15.127, and 15.212 and 15.213). We similarly concluded that a Code of Conduct, to be effective, should apply to all operators in all parts of the country and that the recommendations in relation to municipal operators should apply to the areas of operation of the remaining municipals. In reaching this view, we judged that a national approach to these important aspects of regulation of the bus industry is less likely to lead to confusion among operators and other stakeholders than a regime that varies by location. In deciding whether to recommend such changes, we have had regard to the important contribution of these measures to the effectiveness of our remedy package (see paragraphs 15.111 and 15.112) and to the potential costs of introducing these changes (see Appendix 15.8).

(c) In relation to the bus station access remedy, we are able to target this measure on a relatively small number of local areas, by reference to the nature of the management of the bus station, which gives rise to this aspect of the AEC (see paragraphs 15.227 to 15.235).

15.564 Similar considerations have led to our decisions relating to the geographic scope of the other remedy measures. As regards tendering for supported services, we took the view that best practice guidance would be most effective if developed at a national level and is available to assist all LTAs within the reference area; we similarly concluded that all LTAs would benefit from having information about newly deregistered services. Given this, we took the view that a national approach to these measures was less likely to lead to confusion than an approach which varied by location. Competition law operates on a UK-wide basis and the need for effective competition enforcement and compliance similarly applies throughout the reference area. Decisions on partnerships are inherently local, though some important common principles apply and we consider that all LTAs would benefit from the ability to discuss competition aspects of partnerships with the OFT through the forum that we have recommended be set up. BSOG is a matter for national governments, and it makes sense for our recommendations to be made at a national level.

15.565 This approach is a pragmatic and proportionate approach to the geographic scope of our remedies. We preferred this approach over applying a quantitative threshold using an indicator (or indicators) of market structure or the extent of overlap, at a particular point in time, to determine where remedies should or should not apply.

15.566 Based on these considerations, we are satisfied that the remedy package is no more intrusive than is necessary to remedy the AEC.

Least onerous if there is a choice

15.567 In developing our package of remedies, we have considered a wide range of options. We have consulted many parties for their views about alternative specifications of different remedy options and about different approaches to tackling the AEC. Having gone through this process, we have not been able to identify any less onerous remedy options that would be as effective as the measures that we have decided to take forward. Nor is this a case where there is an alternative that might, all things considered, be a better choice. For example, we preferred our remedy package over franchising, because it remedies the AEC directly, which franchising does not, and is less onerous than franchising. Likewise, as set out in paragraph 15.476, we decided not to pursue divestiture and direct controls on outcomes as a remedy.

15.568 We are satisfied that we chose the least onerous remedy package from the effective options available to us.
Does not produce adverse effects that are disproportionate to the aim

15.569 In deciding whether to proceed with the remedy package, we have considered its potential effects—both positive and negative—on those persons most likely to be affected by it. We have paid particular regard to the potential impact of these remedies on bus passengers and have also had regard to the impact on those operators subject to them and on other affected parties, including government and regulatory bodies, the OFT and other monitoring agencies. We have had regard to the potential for our remedies to give rise to unintended consequence and have taken care in the design of our remedies (as set out in paragraphs 15.11 to 15.432) to minimize the scope for this to happen.

15.570 Our assessment of the potential costs of each of the individual remedy options that we are taking forward is set out in Appendix 15.8. In paragraphs 15.571 to 15.582 we summarize what we judged to be the most important considerations that were relevant to this aspect of our proportionality assessment.

- Benefits of the remedy package

15.571 We looked first at the potential benefits of the remedy package. In considering how markets may develop with remedies in place, the CC will consider both benefits that are relatively easy to quantify (such as lower prices or higher frequency) and benefits that are more difficult to quantify (for example, the dynamic benefits of increased rivalry on productivity and innovation). Both types of benefit are important.

15.572 By increasing competitive pressures in bus markets and creating an environment in which competition is more likely to be sustained, our remedies are likely to reduce substantially the customer detriment that we have identified. Customers are likely to benefit from increased competition in various ways. These include increased service frequency, keener rivalry on fares, a greater choice of operators, as well as the dynamic benefits of innovation and responsiveness to customers’ needs that are associated with competitive markets.

15.573 It is not possible to quantify with precision the customer benefit associated with increased competition. We have not been able to quantify every aspect of the detriment resulting from the AEC, nor are we able to quantify with precision how much of this detriment would be removed by our package of remedies. Nonetheless, in light of our assessment of the effectiveness of the remedy package in achieving its aim (see paragraph 15.546), we expect the detriment we have identified in paragraphs 14.23 to 14.46 to provide a reasonable indication of the potential customer benefits that could result from increased competition following introduction of the remedy package. We estimate that the customer detriment that could be avoided by effectively addressing the AEC to be considerably in excess of £72 million a year and likely to fall within the range of £115 million to £305 million a year.

15.574 We also expect our remedy package to deliver benefits to passengers in addition to the removal of the quantified customer detriment resulting from the AEC. A more detailed discussion of these wider benefits is contained in Appendix 15.8.460

15.575 For example, we would expect the introduction of a multi-operator ticketing scheme to an area to result in greater convenience for passengers from having the option of purchasing a multi-operator ticket, enabling them to use any bus covered by the scheme. We would also expect the provision of fair access to bus stations to result in

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460 See in particular Appendix 15.8, paragraphs 50 & 51 (in relation to ticketing) and 99 & 100 (in relation to partnerships).
increased convenience for customers as competing operators will not be deterred or
prevented from using the station by price or other conditions of access. Action to
prevent cheap exclusion will reduce the inconvenience to customers associated with
practices such as stand blocking. In addition, well-targeted actions and investments
taken through quality partnerships, for example providing better information to
passengers about bus services, have the capacity to deliver passenger benefits.

15.576 While these wider benefits to passengers do not form part of our consideration of the
benefits associated with remediying the AEC, we would expect them to carry some
weight with the bodies to which we are directing our recommendations.

• Costs of remedies

15.577 We also considered potential costs of our remedies, including costs to business and
customers. Such costs may arise in various forms, for example:

(a) A remedy may result in implementation, monitoring and compliance costs.

(b) A remedy may result in unintended distortions to market outcomes. Such distor-
tions may adversely affect the economic interests of customers and reduce
economic efficiency.

(c) If remedies extinguish RCBs, the amount of RCBs forgone may be considered to
be a relevant cost of the remedy.

15.578 Excluding partnerships, for which we would expect local cost-benefit analysis to be
conducted on a case-by-case basis, we have estimated the total one-off costs of
implementing our remedy package to fall within a range of £4.0–£15.9 million. Our
estimate of ongoing costs falls within a range of £2.0 - 4.8 million a year.\footnote{For the reasons set out in Appendix 15.8, paragraph 91, we have not included in this estimate any ongoing costs associated with our recommendations relating to merger control. As set out in paragraph 92 of that appendix, to the extent that any such costs are incurred in practice, they would, in our view, be justified by the contribution of effective merger control in this sector to the effectiveness of our remedy package.} We do
not expect other non-quantified, costs to make a material difference to these ranges
(see Appendix 15.8 for a derivation of these figures).

15.579 We gave careful consideration to the scope for other economic costs and distortions
to arise from the elements of the remedy package:

(a) With regard to ticketing, we considered various potential distortions, including the
possibility that a reduction in the proportion of passengers using single-operator
tickets might reduce the incentive on operators to compete on price, the possibil-
ity that the remedy might result in reduced network coverage, the possibility that
the remedy might increase the scope for coordination between operators, and
possible distortions to the pricing of MTCs. For the reasons summarized in
Appendix 15.8, paragraphs 21 to 30, we did not find that these distortions were
likely to arise in practice.

(b) With regard to operator behaviour, we acknowledge that an increase in notice
periods can lead to a delay in the implementation of service changes and that this
delay can result in some costs to bus operators and/or passengers. Taking into
account the opportunities to avoid or mitigate these costs, however, we conclude
that they are likely to be small (see Appendix 15.8, paragraphs 65 to 75). We
considered the potential for other distortions to arise from other aspects of this
remedy. However, for the reasons set out in paragraphs 15.110 to 15.221, which
include decisions made about the design of the remedy, we concluded that other potential distortions associated with these restrictions on operator behaviour are unlikely to give rise to material economic costs.\footnote{See, in particular, paragraphs 15.129–15.139 (14 days’ notice to LTAs); 15.146–15.151 (extension of notice period for service changes); 15.171–15.181 (frequent service registration); 15.183–15.193 (code of conduct); and 15.202–15.211 (protection for mutuals).}

\((c)\) With regard to partnerships, we considered the risks of distortions to competition associated with raising barriers to entry, unnecessarily constraining the scope for operators to improve their service offering and facilitating coordination that goes beyond what is legal and necessary to deliver passenger benefits. These risks are explicitly highlighted in our recommendation and we have recommended the creation of a forum to enable LTAs and other stakeholders to discuss potential competition concerns with the OFT (see Figure 15.6). We therefore do not expect our recommendations with regard to partnerships to introduce any distortions.

\((d)\) In relation to efficient competition enforcement, we have considered the risk that our recommendations in relation to merger control could increase barriers to exit, by making it harder for small operators to sell their business to one class of buyer. Our assessment is set out in Appendix 15.8, paragraphs 93 and 94, where we conclude that the benefits of effective merger scrutiny are likely to outweigh this very limited risk. We therefore do not expect these recommendations to introduce any material distortions.

\((e)\) We did not identify any material distortion risks associated with the remaining remedies within our package.

15.580 We therefore conclude that, in light of the design of our remedies, the potential for distortions to arise as a result of individual measures and of our remedy package taken as a whole is low. We expect that there will be some costs to operators and/or passengers arising from delays in the implementation of service changes. However, taking into account the opportunities that exist to avoid or mitigate these costs, we expect any such costs to be small (see paragraph 15.579(b)).

15.581 As set out in paragraph 15.493, we do not expect that our remedy package will result in the loss of any RCBs, because we have not identified any RCBs to which we should have regard.

• \textit{Comparison of beneficial effects and costs of remedy package}

15.582 As set out in paragraph 15.572, we expect that, on implementation of the remedies package, there will be a substantial improvement in outcomes for customers across the reference area and that the package of remedies will substantially reduce the customer detriment resulting from the AEC that we have found. We set out the costs of our remedies in paragraphs 15.577 to 15.581 and Appendix 15.8.

15.583 In light of the very significant difference in scale between the customer detriment and the costs of our remedies, and because of our expectation that the remedy package will substantially reduce the customer detriment, it is therefore clear that the benefits of our remedies package are likely to exceed the costs of the remedies package by some margin. In light of our consideration of the timescale over which the remedies will take effect (see paragraphs 15.523 to 15.532), we expect our remedy package to deliver substantial net benefits within three to six years of publication of our final
report. We expect the net benefit to customers to grow over time as implementation costs are only incurred in the initial period.

15.584 Based on the above assessment, we conclude that taken as a whole, the beneficial effects of this package are likely to outweigh its costs.

15.585 We have not been able to quantify the benefits and costs of implementing the remedy package within individual local markets. While we have been able to estimate the overall scale of customer detriment within the reference area, we have not been able to estimate how this detriment is distributed across markets within the reference area (see paragraph 14.28). Likewise, we have left scope for the detailed implementation of particular remedies, for example in relation to ticketing and partnerships, to be determined locally. Decisions about the implementation of these remedies are likely to affect the cost of the solution that is adopted, and will ultimately be a matter for the relevant local stakeholders, rather than for ourselves. Nonetheless we judge that it is unlikely that the net effect of implementing our remedies in particular parts of the reference area will be harmful. We reach this judgement in light of our overall assessment of the costs and benefits and the scope that we have provided for solutions to be tailored to specific local circumstances.

15.586 In response to the provisional decision on remedies, Stagecoach submitted that we had not shown the impact of consumer welfare of individual remedies and that it was therefore not possible to compare the benefits of individual remedies to their respective costs to assess the overall cost efficiency of the remedy. Arriva similarly submitted that it had been surprised that we had not considered the effect of each remedy taken by itself with respect to the AEC and then established whether the addition of a further remedy outweighed the remaining detriment. As an example, Arriva suggested that the ticketing remedies set out in Figure 15.1 might be considered to be sufficient and did not need to be complemented by the changes to service registrations set out in Figure 15.2.

15.587 The AEC that we have found arises as a result of combinations of market features, and the measures within our remedy package work in combination to remedy the AEC. We have identified important synergies between these measures (see paragraphs 15.506 to 15.510) which in our judgement make it inappropriate to seek to quantify the impact of each individual measures on customer welfare. We took the view that the more relevant quantitative comparison is between the costs and benefits of the remedy package taken as a whole (see paragraph 15.584).

15.588 While we did not seek to quantify the incremental effects of each measure, we did, however, give careful consideration to the contribution of each measure to remedying the AEC, including its contribution as part of the package. Through this qualitative assessment, and mindful of our assessment of costs in Appendix 15.8, we reached the judgement that each remedy made a sufficient contribution towards remedying the AEC to justify its inclusion in the remedy package.

Conclusion on proportionality of remedy package

15.589 We concluded that our remedy package was a reasonable and proportionate response to the AEC that we had found.

463 Stagecoach response to provisional decision on remedies, paragraph 2.20.
464 Arriva response to provisional decision on remedies, paragraph 7.2.
465 See, for example, paragraphs 15.146–15.151 in relation to the extended notice period for changes to service registrations.
Decision on remedies

15.590 We have decided on the package of remedies as summarized in paragraph 15.495 and Figures 15.1 to 15.7.

15.591 In our judgement, this represents as comprehensive a solution as is reasonable and practicable to the AEC and resulting customer detriment that we have found.