

**CAMPAIGN FOR BETTER TRANSPORT
COMPETITION LAW & BUS SERVICES**

ADVICE

INTRODUCTION

1. The Campaign for Better Transport ('CBT') is an independent organisation concerned with promoting a sustainable transport policy and encouraging greater use of public transport, walking and cycling. We are asked to advise CBT on the application of UK competition law to bus services by the Office of Fair Trading ('OFT'). In particular, CBT considers that there is scope for greater cooperation between bus operators on matters such as ticketing, routing, timetabling etc., which would benefit passengers. CBT is concerned that operators may be refraining from such cooperation, or even discussing such cooperation, because of a fear of infringing competition law.

2. CBT accepts that competition brings benefits to consumers through lower prices, and by encouraging improvements in customer service and innovation. However, the bus services market is not currently working well from the point of view of attracting and retaining passengers – bus use is generally in decline. CBT believes that a lack of clarity in the application of competition law to bus services may be discouraging cooperation between bus operators that would benefit passengers. CBT believes that the OFT may be taking an unnecessarily restrictive approach, focussed on the promotion of competition and reducing barriers to entry, rather than on passenger interests more generally.

3. We are asked to advise CBT on the OFT's current approach, on whether that approach is a lawful and reasonable one, and on possible changes to competition law and/or policy as it applies to bus services, which might encourage operators

to cooperate on such matters as ticket-sharing, timetabling and route-sharing in order to improve services and attract passengers.

4. We are aware of, and have noted, the conclusions of the House of Commons Transport Select Committee in its report *Bus Services Across the UK*, 26 October 2006 HC 1317¹, in particular their call for ‘a thorough review of how the Competition Act applies to bus services’ and their conclusion that the OFT is wrong to take the view that the bus is not ‘in competition’ with the car.

SUMMARY OF ADVICE

5. A number of industry bodies have suggested that the prohibitions on anti-competitive behaviour in the Competition Act 1998 (CA 1998), or their current enforcement by the OFT, may be an obstacle to certain forms of cooperation between bus operators that may create new services for passengers and promote greater use of buses. Certainly, the combination of deregulation (in 1985) and the application of competition law to the market does not appear to have reversed a long-term decline in bus use.
6. The OFT’s interim document 448 *Frequently asked questions on competition law and the bus industry* (July 2006)² sets out the OFT’s current approach to the application of competition law to local bus services. It focuses heavily on the promotion of actual or potential competition and expresses the view that the application of competition law should lead to more people travelling by bus.
7. In our view, the approach outlined in OFT 448 is not an unlawful approach in the sense of being one that no reasonable competition authority could pursue. Aside from the limited provisions of the Transport Act 2000, there are no ‘special rules’ for buses and there is no ‘carve out’ under UK or EC competition law that places bus operators under a different system of rules. There is scope under the present law to establish that agreements do not appreciably restrict or distort

1 www.publications.parliament.uk/pa/cm200506/cmselect/cmtran/1317/1317.pdf

2 www.of.gov.uk/shared_of/business_leaflets/competition_law/of448.pdf

- competition; i.e. that they fall outside the CA 98 Chapter I prohibition altogether or, if they are within the prohibition, that they can nevertheless be shown to have passenger benefits that outweigh the restrictions on competition.
8. However, there does appear to be a disconnect between the application of the competition rules and the promotion of economic activity in the bus services market. One problem is that agreements between actual or potential competitors that involve some pooling of capacity and agreement on how that capacity is to be allocated, and at what price, may automatically be regarded as illegal. It is not clear that the approach outlined in OFT 448 is sufficiently, or appropriately, focussed on questions of consumer benefit and harm.
 9. In our view, there is a strong argument for saying that the focus of the OFT should change, and that OFT 448 should be redrafted to provide clearer guidance to operators and to focus more clearly on the likely economic effect of an agreement and questions of passenger benefit. There should be no presumption that necessary coordination must exclude certain forms of behaviour (e.g. agreements on timetabling or prices), and any assessment of the effect of an agreement should take into account the distinct features of bus operations, such as the fact that demand is heavily influenced by factors outside the control of bus operators themselves. In particular, where decisions are taken on the basis of protecting potential new entrants to the market, the OFT should be realistic about the prospects of another company actually entering a local market.
 10. If passengers are able to get new bus services that meet their demands at prices they are willing to pay, that is *prima facie* in the public interest (so far as having a sustainable transport policy is concerned), and any rule that stifles such activity, even in the name of protecting competition, works contrary to that interest. How competition rules are being applied may stifle beneficial cooperation. It seems likely, or at the least very arguable, that the treatment by the OFT of certain types of agreement as not capable of being justified may work against the public interest by discouraging the kind of risk-sharing that is essential to investment in

new bus transport services, where certain obligations relating to the use of capacity and prices may be the necessary foundations for the joint venture itself.

11. If Parliament were to agree with the approach we recommend, the Local Transport Bill could be amended to require the OFT to assess agreements between bus operators by reference to likely economic effect and questions of passenger benefit. Moreover, we see no reason why the modified competition test proposed in the draft Bill for voluntary partnership agreements and related agreements could not be applied more generally to *all* agreements between bus operators.

THE COMPETITION ACT 1998 & THE OFT'S CURRENT APPROACH

12. The CA 1998 contains two prohibitions on anti-competitive behaviour, known as the Chapter I prohibition and the Chapter II prohibition:
 - (a) the Chapter I prohibition forbids agreements between undertakings, decisions by associations of undertakings or concerted practices that may affect trade in the United Kingdom and have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom;
 - (b) the Chapter II prohibition forbids 'any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position... if it may affect trade within the United Kingdom'.
13. For present purposes, we are concerned with the Chapter I prohibition, which is the prohibition on anti-competitive agreements, and which may be discouraging cooperation between competing bus companies. Bus operators may be concerned that discussions or cooperation on ticketing, routes or timetabling may be viewed by the OFT as amounting to an agreement falling within the

Chapter I prohibition, i.e. one that has as its *object* or *effect* the prevention, restriction or distortion of competition.

14. The OFT has published a document outlining its views about the application of the CA 1998 prohibitions to the bus industry: *Frequently asked questions on competition law and the bus industry* ('OFT 448', July 2006). The document is said to contain 'the general, preliminary view of officials' and to be 'an interim version' pending publication of the OFT's revised guideline for the block exemption for public transport ticketing schemes (subsequently published in November 2006). The document indicates that the OFT is happy to receive any comments on the interim document.
15. The interim version of OFT 448 reflects the OFT's focus on maintaining and encouraging competition between bus companies. See, for example, at §A1:

'Competition is at the heart of any successful market economy. It provides a stimulus for companies to improve their products and services and to reduce their prices in order to gain an advantage over rivals and win more business. As in any other industry, without the competitive process there would be less incentive for bus operators to offer more attractive and higher quality services and lower fares to passengers'.

16. The document expresses the view that there is no conflict between promoting competition and 'the Government's attempts to promote bus usage', indeed that the application of competition law should ultimately lead to more people using buses:

'By promoting lower fares and better quality services, competition and the application of competition law should lead to more people travelling by bus. Competition law also provides a safeguard to ensure that schemes designed to promote bus use do deliver benefits to consumers.'

[OFT 448, §A2]

17. The document goes on to explain that bus operators can enter into agreements that 'genuinely provide benefits to consumers and do not unnecessarily or excessively restrict competition' (at §A5) and that they are free to speak to each other with a view to reaching agreements on ticketing, subject to the limitations imposed by the Chapter I prohibition. However, there are a number of references in the document to prohibiting cooperation between operators that may make it more difficult for another 'new entrant' operator to enter the market (e.g. at §A4, §A14).

18. As to the practical application of competition law, there are relatively few published OFT decisions applying the CA 1998 prohibitions to bus companies. In CA98/9/2002 *Market sharing by Arriva plc and FirstGroup plc* (30/1/2002)³ two companies were found to have entered into an unlawful market sharing agreement by swapping bus routes in Leeds. In CA98/05/2004 *First Edinburgh / Lothian* (29/4/2004)⁴ the OFT rejected Lothian's complaint that First Edinburgh had infringed the Chapter II prohibition on abuse of a dominant position by reducing its fares and increasing the scale of its commercial bus services in Edinburgh.

19. There have, however, been a number of OFT decisions on whether or not to refer mergers between bus companies to the Competition Commission, and a number of resulting decisions of the Competition Commission. In January 2005, for example, the Competition Commission cleared the acquisition of Hertfordshire bus operator Sovereign Bus & Coach Company Ltd by Arriva plc.⁵ However, in May 2007, the Commission decided that a joint venture between Stagecoach and Scottish Citylink would lead to higher fares and reduced service levels for coach passengers on the Glasgow-Aberdeen and Edinburgh-Inverness routes where

3 www.of.gov.uk/shared_of/ca98_public_register/decisions/leedsbus.pdf

4 www.of.gov.uk/shared_of/ca98_public_register/decisions/lothian.pdf

5 www.competition-commission.org.uk/inquiries/completed/2005/arriva/index.htm

previously the two companies had been the two main competitors, and the Commission required the companies to sell some of the services to a competitor.⁶

20. That latter decision of the Competition Commission (Stagecoach (Megabus) / Scottish Citylink) has attracted some criticism from the industry and from passenger interests. However, the Competition Commission Chief Executive wrote to MPs and MSPs on 9 May 2007, explaining that the Commission gave the companies 'every opportunity to supply convincing argument and/or evidence that the joint venture offered significant benefits for passengers'.⁷ Obviously, the companies and others involved may take a different view.
21. The Competition Commission's task under the Enterprise Act 2002 is to assess whether a merger creates a 'substantial lessening of competition' and, where reasonable and practicable, to take steps to remedy, mitigate or prevent that lessening of competition and any resulting adverse effects. Mergers give rise to different legal issues from those that arise in relation to cooperative agreements that potentially contravene the Chapter I prohibition. Although the approach of the Competition Commission to mergers in the bus industry and other passenger transport services may broadly reflect the view the OFT takes on similar issues, the OFT has no formal role in Competition Commission investigations. Essentially, the OFT is the body that must refer an anticipated or completed merger for investigation by the Competition Commission, by applying the 'substantial lessening of competition' test in sections 22 and 33 of the Enterprise Act 2002.
22. As we understand matters, CBT is primarily concerned with the application of the CA 1998 prohibitions by the OFT rather than the Competition Commission's assessment of mergers within the bus industry, although the two are not completely unrelated. In this Opinion, we have concentrated on the OFT's approach as set out in the July 2006 interim version of OFT448.

6 www.competition-commission.org.uk/inquiries/ref2006/citylink/index.htm

7 www.competition-commission.org.uk/inquiries/ref2006/citylink/pdf/cc_chief_exec_letter_to_mps_msp.pdf

23. Overall, it is clear that the OFT regards competition—and the potential for competition from a new entrant—as the key driver for improving services and reducing fares within the bus industry, and thereby encouraging more people to use buses. The alternative view, held by CBT, is that the application of the CA 98 has not led to a significant increase in bus use and that the approach outlined in OFT 448 is unduly concerned with competition *per se* and the interests of potential new entrants into the market, rather than with passenger interests generally.
24. Before going any further, it is worth pointing out the circumstances in which cooperation between bus companies will not breach the Chapter I prohibition.
25. First, companies are free to enter into any agreement or understanding so long as the cooperation does not have the *prevention, restriction or distortion of competition* as its *object* or as its *effect*. Cooperation that does not have such an object or effect does not fall within the Chapter I prohibition at all. ‘Competition’ means actual or potential competition. It seems to us that there is scope for cooperative agreements between bus operators that cannot meaningfully be said to have the object or effect of restricting competition within the meaning of the Chapter I prohibition.
26. Secondly, section 9 of the CA 1998 provides an exemption for any agreement that *prima facie* falls within the Chapter I prohibition (i.e. which does have an anti-competitive object or effect), if that agreement:
- ‘(a) contributes to (i) improving production or distribution or (ii) promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit; and
 - (b) does not impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives; or afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.’

27. Thirdly, under section 6 of the CA 1998, the Secretary of State may make an order, known as a 'block exemption', which exempts certain categories of agreements from the Chapter I prohibition, subject to them complying with certain conditions set out in the relevant order. The Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2001 (as amended in 2005) is an example of such a block exemption. It exempts from the Chapter I prohibition ticketing schemes that provide multi-operator travelcards, multi-operator individual tickets, through tickets and add-on tickets for local travel on buses, trains, trams and domestic ferry services. The OFT has also published (in November 2006) guidelines on the scope and application of that block exemption.⁸

THE DRAFT LOCAL TRANSPORT BILL

28. On 22 May 2007 the Department for Transport published the draft Local Transport Bill, the stated aim of which is to 'help improve public transport across the country and cut congestion in our towns and cities'. As far as bus services are concerned, the draft Bill contains provisions intended to encourage local authorities to improve the quality of local bus services, in particular by extending the use of 'quality partnership schemes' and 'quality contracts schemes' under the Transport Act 2000 and by introducing a modified competition test applicable to 'voluntary partnership agreements' ('VPAs').
29. The draft Bill leaves intact the existing competition test for quality partnership schemes in schedule 10 of the Transport Act 2000 (i.e. whether the scheme will have a 'significantly adverse effect on competition' and, if so, whether it is justified to secure improvements in the quality of vehicles or facilities, other improvements of substantial benefit to users of local bus services and/or to reduce or limit traffic congestion, noise or air pollution, and whether it is proportionate).

⁸ www.offt.gov.uk/shared_offt/business_leaflets/ca98_guidelines/oft439.pdf

30. A modified competition test is now proposed in the draft bill for VPAs between a local authority and one or more operators ('voluntary bilateral/multilateral agreements') and to 'agreements between undertakings, decisions by associations of undertakings or concerted practices' (i.e. cooperation that would otherwise fall under the Chapter I Prohibition in the CA 1998) 'made in connection with' a voluntary multilateral or bilateral agreement.
31. Where such agreements have the object or effect of preventing, restricting or distorting competition, they are, under the draft Bill, subject to a modified competition test. That requires the parties to the agreement to show that the agreement: (a) achieves one of the intentions in the existing Transport Act 2000, schedule 10 test (i.e. ensuring improvements to services for passengers or limiting traffic congestion, noise or air pollution); and (b) satisfies the second part of the test in section 9 CA 1998 (i.e. it does not impose restrictions that are not indispensable to the attainment of those objectives; or that create the possibility of eliminating competition in respect of a substantial part of the services in question).
32. The proposals on competition law in the draft Bill apply only to arrangements involving local authorities. They do not apply to agreements or cooperation between operators that are not made *in connection with* a VPA involving a local authority, and they do not affect the OFT's existing CA 1998 powers in relation to bus and coach services more generally. However, if Parliament considered it appropriate, we see no reason why the modified competition test proposed in the draft Bill for voluntary partnership agreements and related agreements could not be applied more generally to all agreements between bus operators.
33. The Department for Transport has indicated that it wishes to use the current consultation on the draft Bill to 'review the way that competition legislation relates to bus agreements more generally' (see p. 39 of the consultation paper, at box 3.4). That creates an opportunity for CBT to make representations on the

application of competition law to bus services generally, within the context of the consultation.

REASONABLENESS OF OFT CURRENT APPROACH / ALTERNATIVES

34. As we identified above, OFT 448 suggests that the OFT regards competition, and maintaining the potential for competition, as key to improving services, reducing fares and encouraging more people to use buses.
35. However, the Transport Select Committee noted in its October 2006 report *Bus Services across the UK* that, in the period since bus deregulation in 1985, bus patronage has declined (except in London, which is a regulated market where routes are operated under contracts awarded through a tendering process).
36. Contrary to the implication of OFT 448, the data in the Select Committee's report does not support the view that the introduction of the CA 1998 has led to any greater use of bus services. Indeed, it is possible that competition law (or, more particularly, its application by the OFT and the way in which it has been interpreted by bus companies or local authorities), may be an obstacle to encouraging greater use of buses. Certainly, that suggestion is made by certain of those who gave evidence to the Select Committee.⁹
37. Whether or not that is indeed the effect of the CA 1998 and/or the OFT's current approach (and we have no knowledge of the present attitude of the senior management of the OFT on this issue), summarising what we think is the main issue in our Instructions, we are asked to advise on whether the implementation of the CA 1998 by the OFT is unlawful or, if not unlawful, unreasonable, in the sense that another lawful policy could be implemented by the OFT without the OFT being subject to the charge that it is not properly enforcing the law.

⁹ e.g. in the submissions of the Transport Salaried Staffs' Association, FirstGroup plc, and the North West Public Transport Users Forum.

38. In our view, the approach outlined in OFT 448 is *not* an unlawful approach, i.e. one that no reasonable competition authority could pursue. Other than the limited provisions of the Transport Act 2000, there are no ‘special rules’ for buses and no ‘carve out’ under UK or EC competition law that places bus operators under a different system of rules. As we have pointed out above, there is scope under the present law and OFT approach to establish that agreements do not appreciably restrict or distort competition (i.e. that they fall outside the Chapter I prohibition) or, if they do affect competition, that they can nevertheless be shown to have passenger benefits that outweigh the restrictions on competition.
39. The OFT and the Competition Commission share the common objective of making markets work for the benefit of consumers. There can be no doubt that, generally speaking, increased competition does lead to consumers enjoying a better service. However, when there appears to be a disconnect between the competition rules and the promotion of economic activity (as is strongly arguable in this case, and as is indeed argued by those with knowledge of transport markets), the question arises whether a different policy might be pursued within the law, placing greater emphasis on the context of bus operations and the conditions necessary to promote benign cooperation that benefits passengers.
40. One distinct feature of bus operations is that demand is heavily influenced by factors outside the control of bus operators. Those factors include the extent and quality of the road infrastructure and policies determined by local authorities in respect of the use of that infrastructure, including congestion charging. They also include national and local government policies on rival or complementary forms of public transport such as rail.
41. Bus companies, often owned by franchised rail operators, have considerable experience of supplying transport services in response to government tenders. One feature of such arrangements is that, where government considers that certain network benefits are important for consumers but would not necessarily be produced by commercial agreements between operators, they can be made

- compulsory, with the cost essentially being borne by government in the tender price. In other words, cooperation as between transport operators to pursue a public interest objective is common in cases where government procures the services it requires.
42. It seems to us that one of the problems with the present application of the competition rules and the narrow emphasis on promoting competition is that agreements between actual or potential competitors that involve some pooling of capacity and agreement on how that capacity is to be allocated, and at what price, may automatically be regarded as illegal. The OFT may take that view, on the basis that agreements between competitors on price and market sharing offend the most basic principles of competition law (and indeed may give rise to a cartel offence if entered into dishonestly). In those circumstances, even where there is a need for some coordination of activities in order to provide a commercially viable network of bus services—including agreement on who does what and at what price—it is not surprising that executives may regard any such venture as one fraught with regulatory risk.
43. The likely consequence is that companies may not be entering into forms of cooperation that might expand output so as to benefit passengers, for fear of infringing competition law.
44. In our view, there is a legitimate question to be asked about the ‘theory of harm’ to consumers that the OFT is applying. If, in order to provide a new network service, the parties to an agreement can prove that coordination of a particular kind is indispensable and that, absent coordination, those benefits to consumers will not accrue, it seems to us that the correct approach of the competition authority should be to test that proposition and not to reject it as unacceptable solely by reason of the form the cooperation takes.
45. An agreement between existing bus operators that results in a better, or otherwise unavailable, service to passengers but which involves agreement on

- capacity allocation or even price, is far removed from the classic cartel situation where, without justification, prices are raised and markets shared contrary to the interests of consumers. Arguably, the two appear to be considered as falling within the same prohibition, whereas the overall economic effects may be entirely different.
46. The assessment of whether such an agreement between bus operators appreciably restricts or distorts competition (and, if it does, whether it is nevertheless justified within the terms of section 9 CA 1998), should take into account the conditions in which bus services operate, the economic context and the actual structure of the market concerned.¹⁰ In particular, where decisions are taken on the basis of protecting potential new entrants to the market, the OFT should be realistic about the prospects of another bus company actually entering a local market.
47. In conclusion, it seems to us that there is a strong argument for saying that the focus of the OFT should change and that OFT 448 should be redrafted to provide clearer guidance to operators, and to shift the approach towards one that concentrates on questions of passenger benefit. There ought to be a greater focus on the likely economic effect of an agreement, and there should be no presumption that necessary coordination must exclude certain forms of behaviour. Such an approach would give greater weight to the context in which bus operators undertake the risks of commercial joint ventures, in markets largely controlled by government policies, and to the overall policy of considering economic effect rather than form.
48. In our view, there is evidence that the current application of competition law is not encouraging service improvements or an increase in bus passenger numbers, and it is important that the OFT should focus clearly on theories of consumer harm before prohibiting cooperative conduct that consumers can in fact tolerate.

¹⁰ cf. the judgment of the European Court of First Instance in joined Cases T-374/94, T-375/94, T-384/94 and T-388/94 *European Night Services* [1998] ECR II-3141 at para. 136.

- If passengers are able to get new bus services that meet their demands at prices they are willing to pay, that is *prima facie* in the public interest (so far as having a sustainable transport policy is concerned), and any rule that stifles such activity, even in the name of protecting competition, works contrary to that interest.
49. There are a number of legislative options that may be open to government in this context, for example extending the proposed modified test in the draft Local Transport Bill to cover all forms of cooperation, although it is obviously not open to government to disapply the EC competition rules.
 50. If Parliament were to agree with the approach we recommend, the Local Transport Bill could be amended to require the OFT to assess agreements between bus operators by reference to likely economic effect and questions of passenger benefit. The Bill could, for example, require the OFT to have regard to certain considerations (such as the need to encourage greater use of buses or competition between buses and other modes of transport) in assessing the economic effect of any agreement. As explained above, for those agreements deemed to have an anti-competitive effect, the modified competition test proposed for voluntary partnership agreements and related agreements could be applied more generally to *all* agreements between bus operators, even where such cooperation includes agreement on matters such as price and timetabling.
 51. However, even without amending legislation, we think it is possible to improve the current situation simply by the OFT taking a different approach to the assessment of certain types of transparent cooperation between bus operators. In parallel with a revised economic effect / theory of harm approach to agreements in the bus sector, we consider that OFT 448 could be redrafted to provide fuller and clearer guidance for operators, giving more meaningful examples of situations where there is an appreciable restriction on actual or potential competition, and on what types of agreement may be permitted under s. 9 CA 1998. At present, §A5 of OFT448 refers almost exclusively to agreements on ticketing, but says nothing about the possibility of agreements on fares, routing

and frequency of services (thought there is some limited additional guidance at §§A14-A18).

52. We understand that OFT document 448 is in the course of being discussed with government (and is, in any event, expressed to be an interim document). In our view, that document does not currently convey the kind of messages that we think may be required to create incentives for operators to bring forward benign joint ventures. Revising the document and the approach to agreements between undertakings in the bus services sector as suggested above would, we think, be an entirely reasonable policy to pursue within the principles of the CA 1998.

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