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Innovation & Skills

**GOVERNMENT RESPONSE TO THE
COMPETITION COMMISSION'S
REPORT "LOCAL BUS SERVICES
MARKET INVESTIGATION"**

MARCH 2012

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COMPETITION COMMISSION MARKET INVESTIGATION OF LOCAL BUS SERVICES

Government response to the Competition Commission's report "Local bus services market investigation"

March 2012

Introduction

1. This document sets out the Government's response to the final findings and recommendations to Government set out by the Competition Commission in its report '**Local bus services market investigation – A report on the supply of local bus services in the UK (excluding Northern Ireland and London)**'.

Context and background

2. The Office of Fair Trading (OFT) announced on 7 January 2010 that it would be referring local bus services to the Competition Commission (CC). The OFT said it had found evidence that limited competition between operators tended to result in higher prices and lower quality for passengers and that it was concerned about single operators dominating areas.
3. The final report of the subsequent CC market investigation was published on 20 December 2011.
4. In its report, the CC confirmed that there is a lack of head-to-head competition between bus operators in many local markets and also a lack of *potential* competition. It gave the following main reasons:
 - the relevant markets exhibit high levels of concentration e.g. there are only one or two dominant bus operators in many areas;
 - where demand is sufficient to enable head-to-head competition, bus operators tend to compete for passengers on frequency – as people prefer to catch the first available bus – which can lead to instability and, ultimately, undesirable over-bussing ('bus wars') that causes a new operator to exit the market;
 - there are particular barriers to both new entrants into the market and incumbents that wish to expand into new areas of the market – particularly large-scale expansion – including *inter alia* the threat of retaliatory and predatory behaviour, uncertain and potentially significant sunk costs of bringing a route to

profitability, incumbent network advantages such as advantages for larger incumbents arising from an ability to offer more attractive multi-journey tickets than smaller operators, and difficulties accessing suitable bus stations; and

- operators avoiding competing with other operators in their core territories, leading to geographic market segregation. The CC found that this conduct applies in relation to two operators in parts of the North-East of England.
5. The CC also found that competition for the tendering of supported local bus services in certain markets is prevented, restricted or distorted by the way local transport authorities (LTAs) design tenders.
 6. In the view of the CC, this lack of competition in the commercial and tendered market can result in a combination of higher fares, fewer services and lower quality services. In some areas, the effects will be stronger or weaker. The CC estimated that, overall, the annual detriment to consumers and tax payers caused by the lack of competition identified is in the range of £115m to £305m.

Remedies

7. The CC recommended a number of measures to address the detriment and open up local bus markets by reducing barriers to entry and expansion.

Ticketing

8. The CC recommended that the Government (following consultation with the Welsh Government) and the Scottish Government introduce legislation to give local transport authorities additional powers to introduce mandatory, competitively priced bus-only¹ multi-operator ticketing schemes with: effective governance, access for new entrants, zonal coverage (to include travel-to-work areas that go beyond local authority boundaries if necessary), ticket types that correspond to the main types offered by the main operators and which are offered at the same outlets. This would involve providing local authorities greater power than at present to determine the form that such schemes should take.
9. Prior to the introduction of this legislation, the Government (following consultation with the Welsh Government) and the Scottish Government are recommended to develop guidance to assist local authorities and operators in working together voluntarily to introduce such schemes. This should be based on the principles set out above. The CC also recommends the Government monitors the progress of local transport

¹ The Commission has suggested that multi-modal schemes tend to have price premia, and have therefore proven unattractive for those passengers that only need to use the bus

authorities and operators in delivering new schemes and reforming existing schemes in line with these principles.

10. The OFT is also invited to review the Ticketing Block Exemption as it pertains to e-purse schemes and also to revenue sharing for certain multi-operator ticketing schemes.

Operator behaviour

11. The CC recommended that the Government (following consultation with the Welsh Government) make changes to the notice period and requirements relating to the registration and operation of local bus services in England and Wales outside London. This includes:
 - an extra 14-day pre-notification period during which local transport authorities may review and discuss a registration application with the operator;
 - a minimum standard notice period of 90 (as opposed to the current 56) days following acceptance of a change to an existing service registration;
 - a restriction on making changes to any registration application during any notice period except by making a short-notice application and alignment of the reasons for any short-notice application to those used in Scotland; and
 - requiring operators to include the frequency of services, expressed in hourly bands, registered as 'frequent' (those with six or more services per hour). Currently the frequency is not specified.
12. The CC also recommended that Traffic Commissioners introduce and enforce a Code of Conduct for operators to deal with 'cheap' exclusion (stand blocking etc). It is proposed that breach of the Code could result in services being withdrawn.
13. In addition the Commission proposed specific protections for municipal bus companies undergoing a sale process.

Access to bus stations

14. The Commission decided to introduce an order on local bus operators that manage bus stations to provide other local bus operators on 'fair, reasonable and non-discriminatory' terms and to publish Conditions of Use.

Tendered bus services

15. The CC recommended that the Department for Transport update its best practice guidance on tendering for supported bus services, and provides local transport authorities with extra (primary) powers to request and make available information from operators about revenue and patronage of commercial services if they are deregistered. This latter remedy is designed to prevent incumbent operators of commercial services having an unfair information advantage when it comes to tendering for newly supported services.

OFT

16. The CC recommended to the OFT that it give higher priority to identifying bus company mergers and referring them. It has also recommended that the OFT published revised FAQs on the application of competition law to the bus industry.

Partnerships

17. Whilst acknowledging that franchising may have a role to play in some areas, the CC ruled it out as a remedy to address the issues it has identified.
18. Instead, it recommended that local transport authorities consider the potential for voluntary or statutory partnerships with certain characteristics (such as improved information to passengers) to facilitate increased competition, and establish with OFT a regular forum to discuss issues related to the competition assessment of partnership working. The CC recommended that the Department for Transport monitor local authorities' progress in this regard.

BSOG

19. The CC has recommended that in the course of the review of Bus Service Operators Grant, the Department consider how to incentivise effective provision of information, the development and participation in effective multi-operator ticketing schemes and partnership schemes. In addition, the Department is invited to consider how BSOG might be used to incentivise compliance with the proposed operator Code of Conduct.

Government response

20. As set out in the Department for Transport's evidence to the inquiry, bus services are key contributors to both of the Government's transport priorities: creating growth and cutting carbon. They provide access to work, education, healthcare and social activities – connecting communities both urban and rural. Public funding provides around half of local bus market revenues. The Government's focus is therefore on

ensuring passengers and taxpayers receive best value for that funding, and on setting the conditions in which bus services can be improved and patronage increased.

21. The size of the detriment now calculated by the CC is significant, particularly when comparing the upper bound of £305m (which cover England outside London, Wales and Scotland) with the support provided to bus operators in England outside London by the Government in the form of Bus Service Operators Grant (BSOG: £312m in 2010/11). This would indicate that in the worst-case scenario, a substantial proportion of the benefits to passengers provided by BSOG in England outside London is almost entirely offset by the negative impact on fares, frequencies and service quality of the lack of competition. To this should be added the further external costs to society resulting from the congestion and environmental impact of potential bus users forced into purchasing a car by the poorer quality services provided in less competitive markets.
22. The Government therefore welcomes the package of remedies proposed by the CC and intends to take the following action. This action is part of a wider set of proposals under development to revise the way in which bus services are funded and regulated in England outside London. We are committed to improving bus services and increasing bus patronage by providing the funding and regulatory framework for local transport authorities and bus operators to work in partnership to make the bus a more attractive option.
23. Smart and integrated ticketing has a particularly important role to play in improving the bus passenger experience and the Government welcomes the emphasis placed by the CC on competitively-priced and effective multi-operator ticketing solutions.

Guidance

24. In 2012/13, the Government will work with our colleagues in the Scottish Government and the Welsh Assembly Government to produce best practice guidance for local transport authorities on the tendering of supported bus services across the UK (excluding Northern Ireland and London), and to produce new guidance to assist local transport authorities and operators in working together voluntarily to introduce multi-operator ticketing schemes. We will monitor best practice and feed this into the guidance as it is updated.

Secondary legislation

25. In addition, the Government will, in consultation with the Welsh Assembly Government and Traffic Commissioners, develop secondary regulations in 2012/13 to bring about:

- an extra 14-day pre-notification period during which local transport authorities may review and discuss a registration application with the operator. This already occurs in Scotland and is a proposal on which the Department has previously consulted;
 - a minimum standard notice period of 90 (as opposed to the current 56) days following acceptance of a change to an existing service registration;
 - a restriction on making changes to any registration application during any notice period except by making a short-notice application and alignment of the reasons for any short-notice application to those used in Scotland; and
 - a requirement that operators specify the frequency of services currently registered as 'frequent' (those with six or more services per hour) with a default band so only frequencies in excess of this need to be detailed.
26. The Government is committed to minimising the burden of red tape on businesses, including public transport operators. The Department for Transport has previously set out that any new costs on bus operators resulting from the CC's remedies must be offset by the removal of burdens by the Department elsewhere. Therefore, whilst it is our intention to have drafted the secondary regulations before April 2013, we will only be able to make these once equivalent regulatory savings have been secured.

Primary legislation

27. It is our intention that the multi-operator ticketing guidance is able to stimulate ambition among operators and local transport authorities without the need to legislate. However, we recognise the need to keep that option open and, in consultation with the Welsh Assembly Government, we will explore by the end of this Parliament opportunities to bring forward primary legislation to give local transport authorities powers to introduce mandatory, competitively priced bus-only multi-operator ticketing schemes with: effective governance, access for new entrants, appropriate, locally-determined zonal coverage (to include travel-to-work areas that go beyond local authority boundaries if necessary), with ticket types that correspond to, and are sold through the same channels as, the main types offered by individual operators.
28. We will also explore by the end of this Parliament opportunities to bring forward primary legislation to:
- provide Traffic Commissioners with the powers to restrict local bus service registrations 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 on request from the relevant local authority; and

- provide local transport authorities with extra powers to request and make available information from operators about revenue and patronage of commercial bus services if they are deregistered.

Code of Conduct

29. We will work with Traffic Commissioners to determine the most appropriate means of developing and enforcing an operator Code of Conduct to preclude 'cheap exclusion' and emphasize the need for compliance with competition law, in consultation with the Scottish Government, the Welsh Assembly Government and key stakeholders. If legislation is required to enforce the Code, we would look to bring this forward in line with the timetable for secondary and primary legislation outlined above. We would expect the Code to be developed during the period 2012/13.

BSOG

30. As part of the Government's recent review of BSOG, we considered how and whether to incentivise effective provision of information, and the development of and participation in effective multi-operator ticketing schemes and partnership schemes. We have decided that it would not be appropriate to use BSOG to incentivise compliance with the proposed operator Code of Conduct.

Competition

31. The Department for Transport has in its previous evidence to the CC clearly set out the importance this Government attaches to partnership working between operators and local transport authorities in delivering the improvements to bus services that matter to passengers. This forms a key component of the Government's vision for bus services. We therefore welcome once again the CC's recommendation that local transport authorities consider the potential for introducing partnership agreements and multi-operator ticketing schemes to encourage patronage growth and we will continue to monitor their delivery in England.
32. The Department for Transport has also previously set out its view that the competition tests provided in legislation offer sufficient protection to ensure that the benefits of such agreements outweigh any competition risks resulting from the coordination of timetables or fares. The Government fully supports the CC's recommendation that the Office of Fair Trading (OFT) establish with local transport authorities a forum for exploring the practical application of these competition tests and the Department for Transport will work closely with the OFT to ensure the

implementation of beneficial partnerships is not derailed by concerns over being 'anti-competitive'.

33. The Government supports the CC's recommendation to OFT to review, at the earliest possible opportunity, the Public Transport Block Exemption (Ticketing Block Exemption) in relation to acceptable revenue-sharing arrangements for multi-operator individual ticket schemes and acceptable e-purses under competition law.

Conclusion

34. The Government thanks the CC for its thorough report and its measured remedies. It is clear from the CC's work that in many local bus markets competition between local bus operators is prevented, distorted or restricted and that this has significant adverse effects on the provision of bus services on which passengers rely.
35. It is a measure of the degree of seriousness with which the Government has considered these findings that, considerations on BSOG aside, we have agreed to pursue all the recommendations made to us to address this shortfall in competition.
36. However, we do not underestimate the influence of car ownership on demand for bus travel and the need to make the bus more attractive so that it serves not only those passengers who have no choice but to use the bus, but also those potential passengers who do have other choices. Key to this is a stable, reliable and integrated service.
37. In that context, the Government recognises that there exists a legitimate desire amongst local transport authorities and operators to temper the benefits on-the-road competition with more integration and co-ordination in the passenger interest. We also recognise that in those areas of the country where monopolies do exist, attractive and affordable bus services can still be secured through effective partnership working. Local transport authorities therefore have a vital role in facilitating that coordination, and operators must play their part in sensibly assessing the risks to implementation posed by competition law. A proactive OFT will help greatly in reducing the barrier of these perceived risks.

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