
Competition Act 1998

Decision of the Office of Fair Trading

No. CA98/01/2008

Abuse of a dominant position by Cardiff Bus

18 November 2008

(Case CE/5281/04)

Confidential information in the original version of this Decision has been redacted from the published version on the public register. Redacted confidential information in the text of the published version of the Decision is denoted by [...] [C].

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1 INTRODUCTION

A Summary of the infringement

- 1.1 By this decision, of which **Annexes 1 and 2** below form an integral part, ('this Decision'), the OFT has decided that, during the period from 19 April 2004 to 18 February 2005, Cardiff City Transport Services Limited (trading as Cardiff Bus) infringed the prohibition imposed by section 18(1) (the Chapter II prohibition) of the Competition Act 1998 (the Act), by engaging in predatory conduct which amounted to the abuse of its dominant position in the relevant markets.
- 1.2 The Chapter II prohibition provides that any conduct on the part of one or more undertakings that amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.
- 1.3 This Decision arises from a complaint made by 2 Travel Group plc (2 Travel) in November 2004.
- 1.4 In response to 2 Travel's entry into the market with a new no-frills bus service, Cardiff Bus introduced its own no-frills bus service (the 'white service', or 'white services'). Cardiff Bus' white service buses ran on the same routes and at similar times of day as 2 Travel's no-frills services and were run at a loss until shortly after 2 Travel's exit, when Cardiff Bus withdrew them.
- 1.5 Cardiff Bus claimed that it had introduced the white service in reaction to 2 Travel's introduction of no-frills services, with the intention of market testing the no-frills concept. Cardiff Bus also claimed that its decision to withdraw the white service was taken on the basis of an unexpected lack of customer demand, as well as driver shortages.
- 1.6 In this case, in defining the relevant markets, the OFT has considered the scope for demand and supply side substitution. The OFT concludes that the relevant markets are the provision of no-frills and normal bus services as part of the Cardiff Bus network together with urban bus services, and also interurban bus services and urban rail services (to the

extent that they serve the same flows) into and out of Cardiff city centre. In geographic terms, the OFT has considered the supply of these services both on the relevant routes operated by the white services and on a network basis in the Cardiff County area (to capture the effect of network tickets).

- 1.7 While defining the relevant markets both on a route level and a network basis, the OFT considers that the network market is the most relevant for the assessment of dominance because Cardiff Bus relies on its network for its market power. On this basis, the OFT finds that Cardiff Bus' share of this market was over **66** per cent, and that it faced only fragmented actual competition, with no other operator having notable market share.
- 1.8 On a flow-by-flow basis, in terms of the city centre, Cardiff Bus accounted for **72** per cent of all bus services stopping at Cardiff Central Bus Station by frequency. Outside the city centre, Cardiff Bus had a market share on each of the small flows typically above **75** per cent.
- 1.9 Although the OFT considers that supply side substitutability is unlikely to constrain Cardiff Bus, as a cross-check, the OFT has also considered the implications for the definition of the relevant market of taking into account supply side substitution. On this basis, Cardiff Bus' market share was **69** per cent within a 30-minute isochrone from Cardiff Central Bus Station.
- 1.10 In terms of actual competition, therefore, on the basis of its frequency shares, Cardiff Bus was by far the largest operator of bus services both on a flow-by-flow and network basis. Furthermore, Cardiff Bus was the only significant provider of urban commercial bus services in the County with its actual competitors focusing on operating either tendered or interurban services. Cardiff Bus' rivals therefore did not have sufficient presence on the relevant routes, either individually or collectively, to exert a significant constraint on it. In addition, Cardiff Bus' independence from actual competitors was reinforced by the lack of potential for supply side substitution.

- 1.11 Potential competition from train operators, in the short- to medium-term at least, was very unlikely and the potential for entry and expansion on the part of bus operators was also limited, both at the network level and on individual routes. Barriers to entry and expansion by existing bus operators included the strength of Cardiff Bus' network, the costs of entry, and the perception on the part of smaller operators of Cardiff Bus' reputation for responding aggressively and selectively to entry or expansion on particular routes. Potential competition from this source was therefore limited.
- 1.12 Overall, taking the evidence in the round, the OFT concludes that the limited actual and potential constraints on Cardiff Bus at the time of the operation of the white service support the conclusion that Cardiff Bus had sufficient market power to be able to act independently of its competitors, customers and consumers. Therefore, the OFT concludes that Cardiff Bus held a dominant position in the relevant markets.
- 1.13 Cardiff Bus provided little in the way of contemporaneous documents to support its explanation that the white services were introduced to test market demand for no-frills services, rather than merely to divert passengers from 2 Travel. The OFT identified evidence that conflicted with Cardiff Bus' explanation that it was conducting a market test. This included evidence that Cardiff Bus planned to launch its no-frills white services not as a true market testing exercise, but in order to divert potential customers away from 2 Travel. There was also evidence that Cardiff Bus publicly disparaged the concept of no-frills services and avoided promoting them.
- 1.14 Further to this, the OFT identified evidence that Cardiff Bus launched its white services with exclusionary intent – in other words, with the intention of diverting prospective customers away from 2 Travel and thereby forcing 2 Travel out of the market, thus protecting Cardiff Bus' dominant position, and not with the intention of competing on the merits or carrying out a genuine market test. This includes the fact that the white services were launched at or around the same time, and on the same routes, as 2 Travel's no-frills bus services. It also includes the substantial preparations made by Cardiff Bus to respond aggressively to

2 Travel's entry, and ongoing assessment by Cardiff Bus of the threat posed by 2 Travel. In particular, the evidence demonstrates that the launch and continued operation of the white services was loss-making for Cardiff Bus. Overall, the revenues generated by the white services did not even cover the costs of paying the wages of the drivers who drove the white buses.

- 1.15 There is little evidence that Cardiff Bus considered the likely impact on its profits of launching the white services. Rather, the contemporaneous evidence suggests that Cardiff Bus simply wanted to divert passengers away from 2 Travel and did not consider whether or not the white services would be profitable in their period of operation. In the OFT's view, this failure to consider whether the white services would be profitable does not undermine, but rather supports, a conclusion that the launch of those services was motivated by exclusionary intent. Once the white services were running, it would have quickly become evident to any objective observer in the position of Cardiff Bus that the services as run were loss-making and a commercial failure.
- 1.16 In all the circumstances, the OFT concludes that the evidence is sufficient to demonstrate that Cardiff Bus was reacting to 2 Travel's entry by attempting to force the entrant to retreat from the market. Cardiff Bus' white services were not, therefore, launched as a market test but were launched and operated simply for the purpose of driving out 2 Travel, rather than making profits for Cardiff Bus or fulfilling any other legitimate commercial strategy.
- 1.17 In the OFT's view, Cardiff Bus' conduct contributed to maintaining and strengthening its dominance and did not constitute 'normal competition on the merits', but was predatory and an abuse of Cardiff Bus' dominant position. Cardiff Bus' operation of its white services lasted from 19 April 2004 to 18 February 2005, which is therefore the duration of its predatory conduct.

B Proposed action by the OFT

- 1.18 The Act provides that the OFT may impose on an undertaking, which has intentionally or negligently committed an infringement of the Chapter II prohibition, a financial penalty and/or directions to bring the infringement to an end.¹
- 1.19 Cardiff Bus benefits from immunity under section 40 of the Act, which provides limited immunity from financial penalties for conduct of minor significance in relation to infringements of the Chapter II prohibition. Conduct is considered to be of minor significance if the annual turnover of the undertaking considered to have infringed the Chapter II prohibition does not exceed £50 million.² In this case, the OFT is not imposing a financial penalty on Cardiff Bus.

¹ Sections 33 and 36 of the Act relate to directions and penalties respectively. Further details on penalties and directions (and other consequences of an infringement of the Chapter II prohibition) are available in the competition law guideline *Enforcement* (OFT407). See: http://www.offt.gov.uk/shared_offt/business_leaflets/ca98_guidelines/oft407.pdf.

² Full details of how turnover is to be calculated can be found in the Competition Act 1998 (Small Agreements and Conduct of Minor Significance) Regulations 2000 (SI 2000/262). See: <http://www.opsi.gov.uk/si/si2000/20000262.htm>.

2 THE FACTS

A Introduction

- 2.1 In 1985 bus services in the UK (with the exception of London) were deregulated under the Transport Act 1985. Following deregulation, bus services are now provided by private operators.
- 2.2 Private operators can provide bus services in two different ways: commercial and tendered. Commercial services may be provided wherever the private operator believes it will be profitable to do so. Tendered services consist mainly of routes which have been identified by the local authority as necessary but which may not be commercially viable for private operators to provide, such as rural routes and school bus services. These services will be offered on contract and may be subsidised by the local authority.
- 2.3 The main difference between commercial and tendered services is the way in which they are financed. On a commercial service, the bus operator will be seeking to earn sufficient revenue from carrying passengers to cover the costs of the service.³ With regard to tendered services, section 63(5)(a) of the Transport Act 1985⁴ provides that a local authority can enter into an agreement to subsidise services where the service in question would not be provided without subsidy.
- 2.4 The Code of Practice on Tendering⁵ states that: '...the terms of authorities' subsidy powers need not constrain authorities to subsidising services only along routes where no commercial services whatsoever will be available'. Local authorities have to assess how far registered services meet the transport requirements identified in their particular jurisdiction.

³ Either directly, through charging a fare to the individual passenger, or by deriving income from a multi-operator travelcard scheme for providing services to the passengers.

⁴ See: http://www.opsi.gov.uk/RevisedStatutes/Acts/ukpga/1985/cukpga_19850067_en_1.

⁵ Contained in the Annex to Local Authority circular 5/85, 1985.

B The regulatory background

- 2.5 In order to provide bus services, operators must first register with the relevant Traffic Commissioner. There are seven Traffic Commissioners, each responsible for a specific geographic area: North Eastern, North Western, West Midlands and Wales, Eastern, Western, South Eastern and Metropolitan and Scotland.
- 2.6 The Traffic Commissioners are statutorily independent and appointed by the Secretary of State for Transport. The Traffic Commissioners are responsible for:⁶
- the licensing of the operators of Heavy Goods Vehicles (HGVs) and of buses and coaches (Public Service Vehicles, or PSVs),
 - the registration of local bus services, and
 - granting vocational licences and taking action where necessary against drivers of HGVs and PSVs.⁷
- 2.7 When necessary, a Traffic Commissioner can hold public inquiries, for example to consider disciplinary action against bus operators which have not observed the conditions of their licences.
- 2.8 A company wishing to operate a bus service is first required under the Public Passenger Vehicles Act 1981⁸ to obtain an operator's licence. Before being granted a licence, operators must satisfy the Traffic Commissioner that they are of good repute, of appropriate financial

⁶ A summary of the Traffic Commissioners' responsibilities may be found at:

http://www.dft.gov.uk/stellent/groups/dft_roads/documents/divisionhomepage/032066.hcsp

⁷ The Traffic Commissioner for Scotland is also responsible for dealing with appeals against decisions by Scottish local authorities on taxi fares, and appeals against charging and removing improperly parked vehicles in Edinburgh and Glasgow.

⁸ See:

<http://www.statutelaw.gov.uk/content.aspx?LegType=All+Primary&PageNumber=45&NavFrom=2&parentActiveTextDocId=444897&activetextdocid=444937>.

standing⁹ and professionally competent. The primary objective of operator licensing is to safeguard the travelling public.

2.9 The Traffic Commissioner may undertake investigations and prosecutions and may disqualify an operator from holding a licence, place conditions on a licence prohibiting the use of specified vehicles, or require the operator to conduct safety inspections at regular intervals. The Traffic Commissioner may also reduce the maximum number of vehicles authorised on the licence or suspend or revoke the licence altogether.¹⁰

2.10 On obtaining an operating licence for its vehicles, an operator must then register¹¹ with the relevant Traffic Commissioner any local services¹² it wishes to supply, as provided for by sections 6 and 26 of the Transport Act 1985 and the Public Service Vehicles (Registration of Local Services) Regulations 1986 (SI 1986/1671). In most cases, the operator must give the relevant Traffic Commissioner 56 days' notice before the service can start.¹³ The operator must also provide:

- its name,
- the number of operating licence(s),
- the start and finish points of the route,
- the description of the route,
- any particular journey modifications,

⁹ Under the provisions of Schedule 3, paragraph 2 of the Public Passenger Vehicles Act 1981, an operator must show that it has readily accessible funds of 9,000 Euros for the first authorised vehicle and 5,000 Euros for each additional vehicle.

¹⁰ Details about the licensing regime for local bus services can be found at:

http://www.dft.gov.uk/stellent/groups/dft_localtrans/documents/page/dft_localtrans_023539.hcs

¹¹ Section 6(2) of the Transport Act 1985 provides that no local bus service can be provided by a bus service operator in any traffic area unless the prescribed particulars of the service have been registered with the relevant Traffic Commissioner.

¹² Local services are defined by section 2 of the Transport Act 1985 as a service where one or more passengers travel less than 15 miles.

¹³ The limited circumstances where an operator can provide less than 56 days' notice are set out in Local Bus Service Registration, a guide for operators (PSV 353A). These circumstances include for example, to meet an urgent and exceptional public transport requirement.

- an indication of any stopping places longer than necessary to pick up or set down,
- any reversing manoeuvres,
- the date the service will start,
- the timetable of the service, and
- the proposed times at each point on the route every 15 minutes.

2.11 Any variation to, or cancellation of, the initial registration also generally requires 56 days' notice (the Traffic Commissioner has discretion to waive this period), except in the case of services registered as 'frequent', where the number of buses on a route will be more than six per hour (that is, one every ten minutes). In this case the timetable does not have to be provided to the Traffic Commissioner, and no notification is needed if the operator decides to further increase the number of vehicles serving the route. All registrations and applications to vary services are publicly viewable.

2.12 The operator is obliged to operate the services as registered. If a service does not match that which has been registered, section 26 of the Transport Act 1985 provides the Traffic Commissioner with various sanctions, such as the removal of the registration, the prevention of registering further services or prevention of specific types of service or services in a particular area. Under section 155 of the Transport Act 2000 (TA2000),¹⁴ financial penalties of up to £550 per vehicle may also be imposed.

2.13 The key aspects of the TA2000 include the provision of Quality Contracts schemes and Statutory Quality Partnership schemes, as well as ticketing schemes. In addition, the TA2000 also provides for a competition test which applies when a local authority exercises one of three functions including inviting or accepting tenders for subsidised services. The OFT does not have the power to impose financial penalties where a scheme does not pass the competition test. The OFT has not

¹⁴ See: http://www.opsi.gov.uk/ACTS/acts2000/ukpga_20000038_en_1.

considered whether the competition test has been passed in this case because the services complained about do not fall for consideration under the provisions of the competition test. This is because the competition test broadly relates to agreements,¹⁵ whereas allegations of predation, as in this case, are more appropriately considered under the Chapter II prohibition.

- 2.14 Section 26 of the Transport Act 1985 also allows the Traffic Commissioner to consider matters of interference with the running of another operator's services.

C The two main parties

i. 2 Travel Group plc (2 Travel)

- 2.15 2 Travel was a small bus and coach company established in 2000. The two principal founders were Mr Bev Fowles and Mr Hugh Francis.
- 2.16 2 Travel initially obtained assets by buying up a small number of failing bus operators. Capital Coaches was purchased in May 2000 from J D Cleverley Limited for approximately £[...][C], bringing with it assets comprising 19 vehicles, a depot in Cwmbran and a maintenance depot in Swansea. 2 Travel also purchased the Arrow Bus Company in 2001, and Dianas Coaches in 2002.¹⁶
- 2.17 On 20 January 2003, 2 Travel was floated on the Alternative Investment Market (AIM), raising approximately £2 million.¹⁷ 2 Travel bought Coach Travel Centre Limited, a clearing house for coach tour

¹⁵ Part 3 of the Local Transport Bill is currently before Parliament. This will, on receiving Royal Assent and coming into effect, make a number of amendments to the Transport Act 2000 and, in particular, to the competition test contained in Schedule 10 of the Transport Act 2000. These changes would not bring the competition issues considered in this Decision within the scope of the competition tests contained within the Transport Act 2000 (as revised by the Local Transport Bill).

¹⁶ Letter from 2 Travel's independent analyst, dated 1 November 2006.

¹⁷ Funds received from the flotation before expenses amounted to £1.6 million. In addition, after flotation a further £550,000 was raised before costs. See Chairman's preliminary statement of results for the year ended 31 August 2003.

operators, on 1 April 2003 for £[...][C] and, in June 2003, it purchased the site for its headquarters at Pentrechwyth for £[...][C].¹⁸

- 2.18 The buses purchased with the companies bought by 2 Travel were supplemented by further vehicle purchases, bringing 2 Travel's total fleet up to 120 vehicles by November 2004.¹⁹ These vehicles were old and without many of the amenities, such as CCTV and wheelchair platforms, expected in modern buses.²⁰
- 2.19 2 Travel aimed to offer a low cost, no-frills service, targeted at senior citizens and young mothers travelling after school hours. It engaged in an entry strategy based on winning contracts for tendered services. These provided a guaranteed income stream upon which 2 Travel could expand and run additional commercial services.²¹ In the case of school run contracts, the vehicles would only be utilised for specific periods in the morning and afternoon, leaving the vehicles and drivers free to be used for commercial services outside those periods.
- 2.20 2 Travel started with services in Swansea and Cwmbran, before branching out into Carmarthen and Neath. In September 2003, 2 Travel won a contract to provide a school bus service – the first of 11 school bus contracts and a further two tendered services it subsequently operated in Cardiff. In late 2003 and early 2004, 2 Travel took out leases from Euroclad Limited and John Greatrex on an additional site for a depot in Cardiff.²²

¹⁸ Letter from 2 Travel's independent analyst, dated 1 November 2006.

¹⁹ Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004, paragraph 2.1.

²⁰ Ibid.

²¹ Ibid.

²² Ibid.

2.21 2 Travel's turnover and operating profit/loss from when it began operating in 2000 is set out at Table 1.²³ On 20 May 2005, a winding up order was made against 2 Travel and it was placed into liquidation.²⁴

Table 1: 2 Travel's turnover and operating profit/loss, 2000 to 2003

Year	Turnover	Operating Profit (Loss)
2000 ²⁵	£566,618	£85,216
2000/01	£2,334,451	£172,930
2001/02	£3,678,935	£535,011
2002/03	£4,245,185	(£686,654)

Source: 2 Travel Annual Accounts, 2000/01/02/03.

ii. Cardiff Bus

2.22 Cardiff City Transport Services Limited (trading as Cardiff Bus), was established in October 1986 as a result of the Transport Act 1985, which required all local authorities to divest their municipal bus operations into private 'arms length' bus companies.

2.23 Cardiff Council is the sole shareholder of Cardiff Bus and is represented on the Cardiff Bus Board of Directors (the Board). The Board comprises eleven Directors out of which seven are non-executive Councillor Directors from Cardiff Council, including the Chairman of the Board. There are three Executive Directors and an Employee Director. Day-to-day management of Cardiff Bus is delegated to the Executive Directors, supported by their management team.²⁶

2.24 The objectives of Cardiff Bus, and the services it operates, are based on the recommendations of the Executive Directors and approved by the Board. The financial arrangements in the company, including the setting of fares, profit targets and investment decisions are all incorporated into

²³ There are no figures available from 2 Travel after 2002/03 because, as a result of internal difficulties, further financial data were not prepared.

²⁴ Letter from 2 Travel's independent analyst, dated 2 October 2007.

²⁵ Not a full year.

²⁶ Letter to the OFT dated 21 January 2008, responding to the OFT's section 26 notice of 20 December 2007.

an annual budget setting process led by the Executive Directors with recommendations being made to the full Board.²⁷

- 2.25 As a private company, Cardiff Bus is not permitted to receive public subsidies and is expected to make a contribution to Cardiff Council by paying it regular dividends, in recognition of the Council's investment in the company.²⁸
- 2.26 Cardiff Bus operates normal livery services ('normal services')²⁹ on an extensive network of routes within Cardiff and into Barry, Vale, Caerphilly, Penarth, Newport, Senghenydd, Blackwood and Tredegar.
- 2.27 Following a service review in 2003, Cardiff Bus developed the 'Cardiff Overground' concept, aiming to serve all areas of Cardiff with a high frequency bus service offering services running every five to 20 minutes.³⁰ The Overground network carries approximately 80,000 people each weekday.³¹
- 2.28 At the time of 2 Travel's complaint to the OFT in November 2004,³² Cardiff Bus' fleet totalled 223 vehicles (comprising 27 double decks, 101 single decks, 95 midibuses), and a reserve fleet of 13 Optare Metrorider Clippers.³³

²⁷ Ibid.

²⁸ See:

<http://web.archive.org/web/20071211041445/http://www.cardiffbus.com/company/history/history.htm>.

²⁹ Cardiff Bus stated that normal services: '...have a strong brand image, high quality vehicles, uniformed staff, CCTV, strong marketing and promotion, high frequency, and services available early to late seven days a week'. Source: letter from Cardiff Bus to the OFT, dated 15 September 2006.

³⁰ See *Cardiff Bus brochure – Driving through a decade of change* (2003).

³¹ See:

<http://web.archive.org/web/20071211041445/http://www.cardiffbus.com/company/history/history.htm>.

³² Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004.

³³ Confirmed in a letter from Cardiff Bus, dated 20 October 2006. As of May 2006, Cardiff Bus had a fleet of 229 vehicles (comprising 22 double decks, 19 articulated buses, 102 single decks, 86 midibuses) and a reserve fleet of 12 Optare Metrorider Clippers. The Optare Metrorider model

2.29 Cardiff Bus' turnover and operating profit/loss since 2000 is set out at Table 2.

Table 2: Cardiff Bus' turnover and operating profit/loss, 2000 to 2007

Year	Turnover	Operating Profit (Loss)
1999/2000	£19,483,000	£298,000
2000/01	£19,912,000	£574,000
2001/02	£19,887,000	£599,000
2002/03	£22,333,000	£577,000
2003/04	£23,451,000	£642,000
2004/05	£25,191,000	£690,000
2005/06	£26,217,000	£145,000
2006/07	£28,395,000	£837,000

Source: Cardiff Bus Annual Accounts, 1999/2000/01/02/03/04/05/06/07.

D Chronology of key developments

i. Chronology of relevant services in Cardiff

2.30 As noted in paragraph 2.20, in September 2003, 2 Travel won a contract to provide a school bus service. This was the first of 11 school bus contracts and a further two tendered services it operated in Cardiff.³⁴ At the same time, Cardiff Bus lost three school contracts to a low cost operator which it thought at the time was likely to be 2 Travel.³⁵

2.31 By October 2004, 2 Travel was providing services to Ysgol Gynradd Glantaf, Ysgol Gymraeg Bro Eirwg, Llanrumney High School and Mary Immaculate High School. 2 Travel also operated two tendered hourly services to hospitals (the 98 – Heath Hospital to Pentrebane, and the 99

is a midi-sized bus, holding up to 31 passengers seated and 13 standing. Cardiff Bus used this model as its reserve fleet and subsequently for its no-frills white service.

³⁴ Letter from 2 Travel's independent analyst, dated 1 November 2006.

³⁵ See Cardiff Bus' Managing Director's report, 9 September 2003, which states, under the heading 'Competition': 'The company has lost three school contracts this September to a low cost operator thought to be 2 Travel'.

– Heath Hospital circular). To provide a base from which to operate the services, 2 Travel opened a new depot in Rumney in eastern Cardiff.³⁶

2.32 Cardiff Bus expected 2 Travel, based on its strategy elsewhere, to introduce commercial services on the back of the tendered services it operated.³⁷ On 2 November 2003, Cardiff Bus registered all of its existing key corridor routes as frequent³⁸ routes with the Traffic Commissioner for West Midlands and Wales (the Traffic Commissioner). Cardiff Bus' Managing Director's report of 11 November 2003 stated, under an Agenda item titled 'Competition', that this enabled '...extra services to be run between those currently operating, on the main corridors without further registrations being made to the Traffic Commissioner'.³⁹

2.33 In keeping with its entry strategy, 2 Travel sought to identify routes which it could operate profitably when the vehicles were not in use for the provision of its tendered and school services.⁴⁰ 2 Travel identified three main corridors, north, west and east, on which it could provide services in Cardiff. It decided to provide two routes along each of the east and west corridors, and one along the north. These mirrored routes already served by Cardiff Bus' normal services,⁴¹ from Cardiff City

³⁶ Letter from 2 Travel's independent analyst, dated 1 November 2006.

³⁷ See the minutes of Cardiff Bus Board meeting, 9 September 2003. See also the minutes of Cardiff Bus Board meeting, 11 November 2003: 'The meeting noted the loss of school contracts and the impact this would have...The meeting noted that 2T [2 Travel] have recently obtained an increase in its operator licence provision at Wentloog to 45 vehicles. A number of actions were being taken to address the potential for a competitive attack in the run up to Christmas including the retention of surplus vehicles'. Furthermore, on 9 March 2004, Cardiff Bus' Managing Director's report noted, under the heading 'Competition', that 2 Travel had registered to run vehicles on five of Cardiff Bus' key services from 19 April 2004, and that '...if this competition is successful there is likely to be a second tranche of registrations, which has already happened in the South West Wales area'.

³⁸ See paragraph 2.11 for an explanation of what is meant by the term 'frequent registration'.

³⁹ See Cardiff Bus schedule of normal livery services and Managing Director's report, 11 November 2003.

⁴⁰ Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004.

⁴¹ 2 Travel stated that: 'Cardiff Bus' normal bus services originate and terminate at the central bus station, travelling via Wood Street and St Mary Street. 2 Travel services originate near the bus station in St Mary Street but on the return journey, travel via Castle Street and terminate

Centre to Ely, St Mellons, Llanrumney, Pentrebane and Pentwyn respectively. 2 Travel estimated that it needed to carry six passengers per journey paying half the maximum fare in order to cover the costs of providing the service.⁴²

2.34 Accordingly, in February 2004, 2 Travel registered with the Traffic Commissioner to run commercial local bus services on five routes. These services were scheduled to run every 30 minutes (two an hour) and were thus less frequent than Cardiff Bus' normal services. The registrations were approved by the Traffic Commissioner and on 19 April 2004, 2 Travel started the following four commercial services.

- 217 - Cardiff City Centre to Ely,
- 244 - Cardiff City Centre to St Mellons,
- 250 - Cardiff City Centre to Llanrumney, and
- 262 - Cardiff City Centre to Pentrebane.

2.35 2 Travel's fifth registered service, the 258 (Cardiff City Centre to Pentwyn), did not commence due to resource problems. The Traffic Commissioner agreed that it could be postponed until November 2004, but in the event 2 Travel never started this fifth service.⁴³

2.36 At about the same time that 2 Travel introduced its commercial services in Cardiff, Cardiff Bus also started to run a new no-frills service. This is referred to in this Decision as the 'white service' (or 'white services') in reference to the fact that the vehicles used on the services were painted white, rather than carrying Cardiff Bus' normal green livery.

2.37 This new white service used all 13 of Cardiff Bus' reserve fleet of Optare Metrorider Clipper midibuses. The white services were introduced on the same routes that 2 Travel had registered to operate

near the bus station in Westgate Street'. Source: Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004.

⁴² Ibid.

⁴³ Ibid.

its commercial services (including the 258 route that 2 Travel did not subsequently operate):

- 117 - Cardiff City Centre to Ely,
- 144 - Cardiff City Centre to St Mellons,
- 150 - Cardiff City Centre to Llanrumney,
- 157/158 - Cardiff City Centre to Pontprennau/Pentwyn,⁴⁴ and
- 162 - Cardiff City Centre to Pentrebanne.

2.38 Unlike 2 Travel, Cardiff Bus did not need to give 56 days' notice to the Traffic Commissioner to operate services on these routes, because it had already registered its existing key corridor routes as frequent routes, enabling it to run extra services in these corridors without further registrations (see paragraph 2.32).⁴⁵

2.39 Cardiff Bus' white service 117 commenced on 19 April 2004, on the same day that 2 Travel's services started. All of Cardiff Bus' other white service routes were in operation by 26 April 2004.⁴⁶

2.40 During this period, 2 Travel was experiencing difficulties in supplying its services in other parts of South Wales. By 16 August 2004, as a result of evidence provided by the Vehicle and Operator Services Agency (VOSA), Carmarthenshire County Council, and Gwent Joint Passenger Unit there were sufficient concerns over 2 Travel's service in Neath,

⁴⁴ Contemporaneous documents indicate that Cardiff Bus' 157/158 service covered the equivalent 2 Travel route (service number 258). See for example *Cardiff Bus Traffic Notice*, 14 April 2004.

⁴⁵ In its response to the OFT's section 26 notice on 11 July 2005, Cardiff Bus provided the OFT with its Schedule of White Bus services. This Schedule indicated that the date of commencement of the 117 service was 19 April 2004, with services 144, 150, 157/158 and 162 starting on 26 April 2004. The OFT notes that Cardiff Bus also supplied the OFT with sheets it had used to gather observations on passenger numbers (called 'Competitive Services Logs') covering the period from 19 April 2004 to 17 December 2004. These logs (discussed further in Chapter 7) indicate that, as well as Cardiff Bus' 117 white service, its 162 and 150 white services were recorded as running for at least part of their routes during the week commencing 19 April 2004. See, for example, the fourth Competitive Services Log in Figure 24, which relates to Monday 19 April 2004 and appears to record the '150' service (including the comment 'B/Bus' in the remarks column against this service).

⁴⁶ Source: Schedule of White Bus services provided by Cardiff Bus to the OFT on 11 July 2005.

Llanelli, Carmarthen, Newport, and Cwmbran for the Traffic Commissioner to commence an inquiry under section 26 of the Transport Act 1985 into its apparent failure without reasonable excuse to operate registered services, failure to display proper destination signs, and concerns about safety.⁴⁷ A hearing into 2 Travel's financial standing was adjourned so that further information could be supplied.

- 2.41 On 25 August 2004, the Traffic Commissioner found⁴⁸ that: 'Of 573 2 Travel services monitored...109 (19 per cent) failed to run at all, and 61 (10.6 per cent) ran outside the limits⁴⁹ almost 30 per cent non-compliant against the 5 per cent which is acceptable'. The Traffic Commissioner further commented⁵⁰ that: 'It appears to me that 2 Travel have been too anxious to grow quickly, and have registered services before they had the physical resources to run them reliably'. As a result of this inquiry, the Traffic Commissioner suspended 10 of 2 Travel's 110 operating licences for the month of September 2004, barred it from using vehicles for any local services other than those registered for the next 12 months, and imposed a fine of £28,600.
- 2.42 On 5 October 2004, the adjourned hearing on 2 Travel's financial standing was held. The Traffic Commissioner decided that he could not conclude matters without additional documents.⁵¹
- 2.43 On 29 October 2004, Cardiff Bus withdrew two of its white services, the 157 and 158.⁵² These had faced no competition from 2 Travel, because the latter had never commenced its 258 service.

⁴⁷ As noted in the appeal decision issued by the Transport Appeal Tribunal (Appeal 2005/7, paragraph 2(i)), the public inquiry of 16 August 2004 discussed concerns over prohibition notices. Prohibition notices are served by VOSA to bus operators where vehicles are found not to comply with operational safety requirements.

⁴⁸ Traffic Commissioner for Wales' Decision of 25 August 2004 in relation to 2 Travel Group plc, paragraph 18.

⁴⁹ Traffic Commissioners have set a target whereby 95 per cent of services should depart from timing points within the bracket of up to one minute early and up to five minutes late. Source: Practice Direction: standards for local bus services, 1 January 2005.

⁵⁰ Traffic Commissioner for Wales' Decision of 25 August 2004 in relation to 2 Travel Group plc, paragraph 15.

⁵¹ Transport Tribunal Appeal Decision 2005/7, 10 March 2005, paragraph 2 (iv).

- 2.44 On 17 December 2004, 2 Travel notified the Traffic Commissioner that it was downsizing to 50 operating licences. At this same time 2 Travel stopped operating its bus services in Cardiff.⁵³
- 2.45 On 21 December 2004, 2 Travel's depot in Cardiff was closed and 'all the staff were laid off, except for the manager at the Cardiff depot who transferred to Swansea'.⁵⁴ At the same time, the depot in Cwmbran was closed due to lack of resources. 2 Travel continued to provide services as normal in Swansea and Llanelli, although it faced increasing financial difficulties.⁵⁵ Also on 21 December 2004, Cardiff Bus withdrew its white service 117.⁵⁶
- 2.46 The Traffic Commissioner remained concerned about 2 Travel's financial standing and issued a decision dated 24 December 2004 revoking all of 2 Travel's operating licences. The Traffic Commissioner considered that he was obliged to assess the availability to 2 Travel of finance on the basis of the licence held, for 110 vehicles. On this basis, he found that not only was there too little money available for 110 vehicles, there was not enough for 50 or even 10 vehicles.⁵⁷ The revocation, however, was suspended pending an appeal by 2 Travel to the Transport Tribunal.⁵⁸
- 2.47 On 14 January 2005, Cardiff Bus withdrew its white service 162⁵⁹ and on 18 February 2005, Cardiff Bus withdrew its remaining white services, the 144 and 150.⁶⁰
- 2.48 On 24 February 2005, the Transport Tribunal heard 2 Travel's appeal against the decision of the Traffic Commissioner and found that the Traffic Commissioner had been '...wrong to go so far as to conclude that there was 'too little money available for 110 vehicles, there is not

⁵² Schedule of white services provided by Cardiff Bus to the OFT on 11 July 2005.

⁵³ Letter from 2 Travel's independent analyst, dated 1 November 2006.

⁵⁴ Ibid.

⁵⁵ Ibid.

⁵⁶ Schedule of white services provided by Cardiff Bus to the OFT on 11 July 2005.

⁵⁷ See the Transport Tribunal Appeal Decision 2005/7, 10 March 2005, paragraph 2(viii).

⁵⁸ Letter from 2 Travel's independent analyst, dated 1 November 2006.

⁵⁹ Schedule of white services provided by Cardiff Bus to the OFT on 11 July 2005.

⁶⁰ Ibid.

enough for 50 or even 10'. The Transport Tribunal stated: 'We think that there may well have been enough for at least 50, but we would prefer up to date figures before expressing any concluded view'.⁶¹ On this basis the revocation was set aside and the matter remitted to the Traffic Commissioner. However, no further action was taken before 2 Travel went into liquidation.

2.49 On 6 May 2005, 2 Travel's contracts for subsidised routes between Llanelli and Carmarthen and for schools services in Llanelli were cancelled by Carmarthenshire County Council, resulting in the closure of the Llanelli depot.⁶² As noted at paragraph 2.21, 2 Travel was placed into liquidation on 20 May 2005. On 26 May 2005, BDO Stoy Hayward was appointed as the liquidator. BDO Stoy Hayward continued to cooperate with the OFT's investigation.

2.50 Table 3 below summarises and compares the services on the relevant routes for Cardiff Bus and 2 Travel, as well as the dates that the no-frills services started and were withdrawn.

Table 3: Cardiff Bus and 2 Travel services on relevant routes

Cardiff Bus normal service ⁶³	Equivalent 2 Travel no-frills service	Equivalent Cardiff Bus white service	Date 2 Travel no-frills service started	Date Cardiff Bus white service started	Date 2 Travel no-frills service withdrawn	Date Cardiff Bus white service withdrawn
57 & 58	258 [not run]	157/158	-	26/04/04	-	29/10/04
17 & 18	217	117	19/04/04	19/04/04	17/12/04	21/12/04
62	262	162	19/04/04	26/04/04	17/12/04	14/01/05
44	244	144	19/04/04	26/04/04	17/12/04	18/02/05
49 & 50	250	150	19/04/04	26/04/04	17/12/04	18/02/05

Sources: Schedule of white services and schedule of normal livery services provided by Cardiff Bus to the OFT on 11 July 2005. Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004. Letter from 2 Travel's independent analyst, dated 1 November 2006.

⁶¹ Transport Tribunal Appeal Decision 2005/7, 10 March 2005, paragraph 13.

⁶² Letter from 2 Travel's independent analyst, dated 1 November 2006.

⁶³ Cardiff Bus' normal services were in operation before 19 April 2003 and continued to run during and after 2 Travel operated its no-frills services.

ii. Chronology of fares

2.51 On 2 November 2003, Cardiff Bus raised the price of adult single and return fares on its normal services, but left child fares unchanged (see Table 4).

Table 4: Cardiff Bus' normal service fares, November 2003

Zone	Adult single (% rise)	Adult return (% rise)
1	65p (8%)	115p (5%)
2	95p (6%)	175p (6%)
3	125p (4%)	225p (4%)
4	155p (3%)	260p (4%)

Source: Cardiff Bus fares booklet, 2 November 2003.

2.52 The fares charged by 2 Travel and Cardiff Bus' white services, and those charged by Cardiff Bus on its normal services as of 26 April 2004, are set out in Table 5. The table shows that on its white services, Cardiff Bus priced below its own normal services (except for initially matching child fares in zone 1),⁶⁴ and that it also priced below 2 Travel's for three out of four zones (shown as shaded).⁶⁵

⁶⁴ On 29 August 2004, Cardiff Bus raised child fares on normal services, with the effect that in zone 1 they then exceeded the white service child fares (see Table 6).

⁶⁵ At its oral representations on 15 October 2007, Cardiff Bus acknowledged that fares on its white services were lower than 2 Travel's on some zones.

Table 5: Fares charged by 2 Travel and by Cardiff Bus' normal and no-frills services, April 2004

Zones	Adult single			Adult return		
	Cardiff Bus		2 Travel	Cardiff Bus		2 Travel
	Normal service	White service		Normal service	White service	
1	65p	60p	50p	115p	110p	80p
2	95p	60p	80p	175p	110p	130p
3	125p	80p	100p	225p	150p	160p
4	155p	100p	120p	260p	170p	190p
Zones	Child single			Child return		
	Cardiff Bus		2 Travel	Cardiff Bus		2 Travel
	Normal service	White service		Normal service	White service	
1	40p	40p	30p	70p	70p	50p
2	60p	40p	50p	110p	70p	80p
3	75p	50p	70p	140p	90p	110p
4	90p	60p	80p	170p	110p	130p

Sources: 2 Travel submission to the OFT, 3 November 2004. Cardiff Bus fares booklet, 2 November 2003. White service fares, stated in internal Cardiff Bus email of 16 April 2004. The shaded fares show where Cardiff Bus' white services were priced below 2 Travel's no-frills services.

2.53 Neither Cardiff Bus nor 2 Travel changed the fares on their no-frills services during their operation. However, on 29 August 2004, Cardiff Bus raised the fares on its normal services (see Table 6 below).

Table 6: Cardiff Bus' normal fares from August 2004

Zone	Adult single (% rise)	Adult return (% rise)	Child single (% rise)	Child return (% rise)
1	70p (8%)	120p (4%)	45p (13%)	75p (7%)
2	100p (5%)	180p (3%)	65p (8%)	115p (5%)
3	130p (4%)	230p (2%)	80p (7%)	145p (4%)
4	160p (3%)	270p (4%)	95p (6%)	175p (3%)

Source: Cardiff Bus fares booklet, 29 August 2004.

E The complaint

- 2.54 2 Travel initially contacted the OFT in April 2004⁶⁶ to complain about Cardiff Bus' response to 2 Travel's new commercial services. On 20 April 2004, 2 Travel again wrote to the OFT, complaining about Cardiff Bus' response to 2 Travel's new services.⁶⁷
- 2.55 On three occasions, the OFT requested further information from 2 Travel in order to consider its complaint in more detail.⁶⁸ However, 2 Travel did not provide the required information and the OFT consequently informed 2 Travel on 13 September 2004 that it would close the case.
- 2.56 On 3 November 2004, 2 Travel submitted to the OFT a detailed complaint⁶⁹ alleging that Cardiff Bus was predating in the provision of certain bus services in Cardiff. 2 Travel alleged that:
- Cardiff Bus was engaging in predatory conduct by introducing no-frills services on routes where it faced competition from 2 Travel,
 - the no-frills services were differentiated from Cardiff Bus' normal bus services in that they used older and lower quality vehicles, did not carry the Cardiff Bus livery, and charged lower fares than its normal services,
 - Cardiff Bus was running its no-frills services a few minutes before 2 Travel's services in order to minimise 2 Travel's passenger numbers, and
 - Cardiff Bus drivers were intimidating 2 Travel drivers.

⁶⁶ Letter to the OFT, undated.

⁶⁷ Letter to the OFT, dated 20 April 2004.

⁶⁸ Letters from the OFT to 2 Travel dated 27 April 2004, 15 June 2004 and 10 August 2004.

⁶⁹ Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004.

F The OFT's investigation

i. Section 26 notices

2.57 On 26 May 2005, the OFT informed Cardiff Bus that it had: '...reasonable grounds for suspecting that the Chapter II prohibition has been infringed in that Cardiff City Transport Services Limited trading as Cardiff Bus ('Cardiff Bus') has abused a position of dominance...'.⁷⁰ To investigate the complaint, the OFT sent notices requiring documents and information under section 26 of the Act⁷¹ to Cardiff Bus and to the third parties listed in Table 7.

Table 7: Section 26 notice recipients

Date sent	Recipient	Response(s)
26/05/2005	Cardiff Bus	11/07/2005
09/08/2005	Cardiff Bus	14/09/2005
24/11/2005	Bebb Travel plc	27/02/2006 24/03/2006
24/11/2005	Glynn Williams Travel	29/11/2005
24/11/2005	EST Bus Ltd	05/01/2006
24/11/2005	EST Coach Ltd	05/01/2006
24/11/2005	Red & White services Ltd	20/01/2006
24/11/2005	Parfitts Motor Services Ltd	20/01/2006
24/11/2005	Rhondda Buses Ltd	20/01/2006
24/11/2005	Aberdare Bus Co Ltd	20/01/2006
24/11/2005	The Valleys Bus Co Ltd	20/01/2006
24/11/2005	Jones Motors	23/01/2006
24/11/2005	Wales and Marches Bus Co	18/01/2006
24/11/2005	RH and DT Edwards Ltd	19/01/2006
24/11/2005	National Express Ltd	18/12/2005
24/11/2005	Islwyn Borough Transport Ltd	05/12/2005
24/11/2005	Newport Transport Ltd	09/12/2005
24/11/2005	First Cymru Buses Ltd	21/12/2005
15/12/2005	Cardiff Bus	13/01/2006 14/02/2006 17/02/2006
17/08/2006	Cardiff Bus	29/08/2006 31/08/2006

⁷⁰ OFT section 26 notice to Cardiff Bus dated 26 May 2005.

⁷¹ Section 26 of the Act empowers the OFT, for the purposes of an investigation under section 25 of the Act, to require any person to produce to it a specified document, or to provide it with specified information, which it considers relates to any matter relevant to the investigation.

		07/09/2006 15/09/2006 22/09/2006
20/12/2007	Cardiff Bus	21/01/2008
21/12/2007	Stagecoach plc	08/01/2008
21/12/2007	FirstGroup plc	18/01/2008
21/12/2007	Arriva plc	21/08/2008
21/12/2007	Veolia Transport UK limited	25/01/2008
21/12/2007	EST Buses Ltd	30/01/2008

ii. Information received without using formal powers

- 2.58 The OFT also informally asked for further information from Cardiff Bus on 11 October 2006 and 13 October 2006. A response was provided by Cardiff Bus on 20 October 2006.
- 2.59 The OFT received information voluntarily submitted by the complainant, in the form of 2 Travel's initial submission of 3 November 2004 and supplementary submissions of 31 January 2005 and 11 February 2005. The OFT also asked for further information from BDO Stoy Hayward on 24 November 2005. A response was provided by an independent analyst retained by 2 Travel and subsequently BDO Stoy Hayward, on 3 January 2006. The independent analyst was asked for further information on 17 October 2006 and responded by letter on 1 November 2006.
- 2.60 On 10 August 2006, the OFT met with representatives of BDO Stoy Hayward, together with 2 Travel's independent analyst.
- 2.61 The OFT also met with the Traffic Commissioner for Wales on 28 July 2006, and with representatives of the following third parties on the dates set out below:
- First⁷² - on 3 August 2006,
 - Arriva Wales - on 3 August 2006,
 - Bebb Travel - on 3 August 2006,

⁷² Throughout this Decision, unless otherwise indicated, 'First' refers to First Cymru.

- Shamrock Travel on 26 January 2006 and 3 August 2006, and
- Stagecoach South Wales - on 4 August 2006.

2.62 Members of the OFT case team visited Cardiff on 3 and 4 August 2006 to meet some third parties as set out above, and to gain firsthand experience of the bus market in Cardiff. This included travelling on a number of Cardiff Bus services and observing types of passengers, levels of congestion and the areas served by the various bus routes.

2.63 The OFT issued a Statement of Objections (SO) in relation to its investigation of Cardiff Bus on 15 May 2007. Cardiff Bus provided its written representations in response to the SO on 7 August 2007. In accordance with the OFT Rules,⁷³ Cardiff Bus was given the opportunity to make oral representations which it made to the OFT on 15 October 2007.

2.64 A number of parties made requests to the OFT for a non-confidential version of the SO. These parties were asked to make representations as to how they could materially assist the OFT in its investigation, in accordance with the OFT's guidelines on involving third parties in Competition Act investigations.⁷⁴ Following such representations, on 21 September 2007, two third parties were each provided with a non-confidential version of the SO for comment. These third parties responded on 2 October 2007 and on 17 October 2007.

2.65 The OFT issued a Supplementary Statement of Objections (SSO) in relation to its investigation of Cardiff Bus on 20 May 2008. Cardiff Bus provided its written representations in response to the SSO on 1 August 2008. In accordance with the OFT Rules,⁷⁵ Cardiff Bus was given the opportunity to make oral representations, but decided not to take this opportunity.

⁷³ OFT Rules 5(4).

⁷⁴ See: *Involving third parties in Competition Act investigations* (OFT451).

⁷⁵ OFT Rules 5(4).

- 2.66 On 14 August 2008, the OFT informally requested further information from Cardiff Bus in relation to Cardiff Bus' written representations. Cardiff Bus provided a response to this request on 21 August 2008.
- 2.67 On 27 October 2008, the OFT set out in a Further Notice in addition to the SSO (the Further Notice), additional information and evidence that it proposed to rely on as corroboration of the OFT's case and which had not previously been put to Cardiff Bus in the SO or SSO, giving Cardiff Bus an opportunity to make representations. Cardiff Bus provided written representations on this information to the OFT on 10 November 2008.

3 LEGAL BACKGROUND

3.1 This Chapter provides an overview of the legal framework against which the OFT has considered the facts in this case.

A The Chapter II prohibition

3.2 Section 18(1) of the Act imposes the Chapter II prohibition which provides that any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the UK or any part of it.⁷⁶ 'Dominant position' in section 18 means a dominant position within the UK or any part of it.⁷⁷

3.3 Section 18(2) of the Act lists some of the abuses that the prohibition is aimed at preventing.⁷⁸ However, the list is illustrative only and not exhaustive, and the Chapter II prohibition can apply to conduct not specifically listed. The fundamental issue is whether the dominant undertaking is using its dominant position in an abusive way. This may occur if its conduct has the effect of restricting the degree of competition which it faces, or of exploiting its market position. A dominant undertaking is under a special responsibility not to allow its

⁷⁶ The Chapter II prohibition does not apply in cases in which it is excluded pursuant to section 19 of the Act. None of the excluded cases are applicable in respect of the infringement that is the subject of this Decision.

⁷⁷ Section 18(3) of the Act.

⁷⁸ Section 18(2) states that conduct may constitute an abuse if it consists of: (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions, (b) limiting production, markets or technical development to the prejudice of consumers, (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage, or (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.

conduct to impair undistorted competition,⁷⁹ including that competition which still remains in the market.⁸⁰

3.4 To find an infringement of the Chapter II prohibition, the OFT must establish:

- that at the time of the alleged infringement Cardiff Bus held a dominant position within the UK or any part of it,
- that Cardiff Bus abused that dominant position, and
- that such abuse may have affected trade within the UK or any part of it.

B Application of section 60 - consistency with European Community law

3.5 Section 60(1) of the Act sets out the principle that, so far as is possible (having regard to any relevant differences between the provisions concerned), questions arising in relation to competition within the UK are to be dealt with in a manner which is consistent with the treatment of corresponding questions arising in European Community law in relation to competition within the Community. In particular, under section 60(2) of the Act, the OFT must act (so far as is compatible with the provisions of the Act) with a view to ensuring that there is no inconsistency with the principles laid down by the EC Treaty and the

⁷⁹ See, for example, Case 322/81 *Michelin v Commission* [1983] ECR 3461, paragraph 57, and Case T-228/97 *Irish Sugar v Commission* [1999] ECR II-2969, paragraph 112.

⁸⁰ Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461, paragraph 91: '...The concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition'. This passage has since often been cited in the European Court and in the Competition Appeal Tribunal (CAT). For example, see *Genzyme v Office of Fair Trading* [2004] CAT 4, paragraphs 482 to 485; *Napp v Director General of Fair Trading* [2002] EWCA 796, paragraphs 23 to 27.

European Court and any relevant decision of the European Court.⁸¹
Under section 60(3) of the Act, the OFT must, in addition, have regard to any relevant decision or statement of the European Commission.

- 3.6 Article 82 of the EC Treaty is the provision in EC competition law equivalent to the Chapter II prohibition.

C Application of Article 82 - effect on interstate trade

- 3.7 Following the application of Council Regulation (EC) No 1/2003⁸² from 1 May 2004, the OFT is required to apply Article 82 in addition to the Chapter II prohibition if an abuse prohibited by Article 82 '...may affect trade between Member States'.⁸³ In this case, since the effects of Cardiff Bus' conduct are considered to be relevant to the provision of bus services in a part of the UK only, the OFT does not consider that Cardiff Bus' conduct may affect trade between Member States. Accordingly, the OFT is not under a duty to apply Article 82 to the particular circumstances of this case and so has not done so. This Decision therefore relates solely to whether the Chapter II prohibition has been infringed.

D Relevant case-law in relation to undertakings

- 3.8 The word 'undertaking' is not defined in the Act or the EC Treaty. It is a wide term that the European Court of Justice has held to cover '...every entity engaged in an economic activity, regardless of the legal status of the entity or the way in which it is financed'.⁸⁴ In this case, Cardiff Bus is engaged in competing directly in the market with other commercial bus providers, and as a result is engaged in an economic activity. On this basis, the OFT considers that Cardiff Bus is an undertaking for the purposes of the Act.

⁸¹ The European Court means the European Court of Justice (ECJ) and the Court of First Instance (CFI).

⁸² OJ L1, 4 January 2003, page 1.

⁸³ Article 3, Regulation 1/2003.

⁸⁴ Case C-41/90 *Höfner and Elser v Macrotron* [1991] ECR I-1979, paragraph 21.

E The concept of dominance

i. Market definition

3.9 Market definition provides a framework for competition analysis and is a key step in identifying any competitive constraints that an undertaking may face. For the purposes of the Chapter II prohibition, the OFT would not consider an undertaking to be dominant unless that undertaking had substantial market power.⁸⁵ The definition of the relevant economic market(s) in which an undertaking operates is a necessary first step in assessing whether that undertaking has market power.

3.10 The relevant market typically has two dimensions: the relevant goods or services (the product market) and the geographic extent of the market (the geographic market).⁸⁶ The OFT's assessment of the relevant market definition in this case is set out in Chapter 4.

ii. Definition of dominance

3.11 The European Court has defined a dominant position as: '...a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers'.⁸⁷

3.12 It has also held that: '...such a position does not preclude some competition...but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions

⁸⁵ See *Abuse of a Dominant Position* (OFT402), paragraph 4.11.

⁸⁶ The OFT's approach to market definition is set out in the competition law guideline *Market definition* (OFT403), which follows a similar approach to that of the European Commission. The European Commission's approach is set out in the Commission Notice on the definition of the relevant market for the purposes of Community competition law (OJ 1997 C372/5).

⁸⁷ Case 27/76 *United Brands v EC Commission* [1978] ECR 207, paragraph 2.

under which competition will develop, and in any case to act largely in disregard of it so long as such conduct does not act to its detriment'.⁸⁸

- 3.13 As stated above, the OFT will not consider an undertaking to be dominant unless that undertaking has substantial market power.⁸⁹ Market power is not an absolute term but a matter of degree, and the degree of market power held by an undertaking will depend on the circumstances of each case. In assessing whether an undertaking has substantial market power, it is helpful to consider market shares and the extent to which an undertaking faces competitive constraints. The most important constraints are existing competition and potential competition. Other factors such as strong buyer power from the undertaking's customers can also be relevant. Available evidence from all indicators will be considered in the round before coming to an assessment of market power.
- 3.14 The OFT's assessment in this case of whether Cardiff Bus is dominant on any market(s) in the UK or any part of the UK is set out in Chapters 5 and 6.

F The concept of abuse

- 3.15 The ECJ has defined the concept of an abuse as: '...an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance or the degree of competition still existing in the market, or the growth of that competition'.⁹⁰

⁸⁸ Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, paragraph 39.

⁸⁹ See *Abuse of a Dominant Position* (OFT402), paragraph 4.11.

⁹⁰ Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, paragraph 91.

3.16 In general, the OFT considers that the likely effect of a dominant undertaking's conduct on customers and on the process of competition is more important to the determination of an abuse than the specific form of the conduct in question.⁹¹

i. Predation

3.17 One of the ways in which a company that holds a dominant position can abuse that dominance in such a way as to infringe UK or EC competition law is by engaging in predatory conduct.

3.18 A summary of the relevant case-law can be found in the judgment of the Competition Appeal Tribunal (CAT) in *Aberdeen Journals Ltd v Office of Fair Trading* [2003] CAT 11, at paragraphs 349 to 358.⁹² As the Tribunal stated after having considered that case-law: '...The cases cited above demonstrate, in our view, that the question whether a certain pricing practice by a dominant undertaking is to be regarded as abusive for the purposes of the Chapter II prohibition is a matter to be looked at in the round, taking particularly into account (i) whether the dominant undertaking has had 'recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators' ...; and (ii) whether such conduct has the effect of weakening or distorting competition in the relevant market, having regard to the special responsibility of a dominant firm not to impair genuine undistorted competition. In our view, these principles apply particularly to the case of a dominant firm facing new entry, where retaliatory measures going beyond what is reasonable and proportionate are likely to require close scrutiny under the Chapter II prohibition'.⁹³

3.19 In Chapter 7, the OFT considers whether Cardiff Bus has abused its dominant position.

⁹¹ See *Abuse of a Dominant Position* (OFT402), paragraph 5.2.

⁹² The Tribunal cited, in particular, Cases C-62/86 *AKZO Chemie v Commission* [1991] ECR I-3359 and C-333/94P *Tetra Pak v Commission* [1996] ECR I-5951 ('*Tetra Pak II*').

⁹³ *Aberdeen Journals Ltd v The Office of Fair Trading* [2003] CAT 11, paragraph 350, citing Case 85/76 *Hoffman-La Roche v Commission* [1979] ECR 461.

G Effect on trade in the UK

- 3.20 By virtue of section 18(1) of the Act, the Chapter II prohibition applies only to conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market if it '...may affect trade within the United Kingdom'. For the purposes of the Chapter II prohibition, the UK means the UK or any part of it where a dominant position is held.⁹⁴ The OFT considers that conduct that is an abuse of a dominant position within the UK will in practice also affect trade there.
- 3.21 To infringe the Chapter II prohibition, the conduct which amounts to an abuse of a dominant position does not actually have to affect trade, as long as it is capable of affecting trade. The CAT held in *Aberdeen Journals* that the test is not read as importing a requirement that the effect on trade should be appreciable.⁹⁵

H Burden and standard of proof

- 3.22 The burden of proving an infringement of the Chapter II prohibition lies with the OFT. The CAT held in *Napp* that: '...As regards the burden of proof, the Director⁹⁶ accepts that it is incumbent upon him to establish the infringement, and that the persuasive burden of proof remains on him throughout...In our view it follows from Article 6(2) [of the European Convention on Human Rights] that the burden of proof rests throughout on the Director to prove the infringements alleged'.⁹⁷
- 3.23 However, the CAT also held in *Napp* that this burden does not '...necessarily prevent the operation of certain evidential

⁹⁴ Section 18(3) of the Act.

⁹⁵ *Aberdeen Journals Limited v Office of Fair Trading* [2003] CAT 11, paragraphs 459 and 460.

⁹⁶ References to the 'Director' are to the Director General of Fair Trading. As from 1 April 2003, the Enterprise Act 2002 transferred the functions of the Director General of Fair Trading to the OFT.

⁹⁷ *Napp Pharmaceutical Holdings Ltd v Director General of Fair Trading*, [2002] CAT 1, at paragraphs 95 and 100. The CAT confirmed this approach in the *Replica Kit* judgment *JJB Sports PLC v Office of Fair Trading* [2004] CAT 17, paragraph 164. See also paragraphs 928 and 931.

presumptions'.⁹⁸ In *Napp* the CAT gave several such examples, including the level of costs: 'That approach does not in our view preclude the Director, in discharging the burden of proof, from relying in certain circumstances, from inferences or presumption that would, in the absence of any countervailing indications, normally follow from a given set of facts, for example...that sales below average variable costs may, in the absence of rebuttal, be presumed to be predatory (see the opinion of advocate General Fennelly in Cases C-395/96P and 396/96P *Compagnie Maritime Belge v Commission* [2000] ECR I-1442 at paragraph 127)'.⁹⁹

3.24 As regards the standard of proof, the CAT held that: '...formally speaking, the standard of proof in proceedings under the Act involving penalties is the civil standard of proof, but that standard is to be applied bearing in mind that infringements of the Act are serious matters attracting severe financial penalties. It is for the Director to satisfy us in each case, on the basis of strong and compelling evidence, taking account of the seriousness of what is alleged, that the infringement is duly proved, the undertaking being entitled to the presumption of innocence, and to any reasonable doubt there may be'.¹⁰⁰

3.25 This statement has been further clarified by the CAT in its ruling in the *Replica Kit* appeals, where the CAT stated that: '...It also follows that the reference by the Tribunal to 'strong and compelling' evidence at [109] of *Napp* should not be interpreted as meaning that something akin to the criminal standard is applicable to these proceedings. The standard remains the civil standard. The evidence must however be sufficient to convince the Tribunal in the circumstances of the particular case, and to overcome the presumption of innocence to which the undertaking concerned is entitled'.¹⁰¹

⁹⁸ Ibid, paragraph 95.

⁹⁹ Ibid. See paragraph 110.

¹⁰⁰ Ibid. See paragraph 109.

¹⁰¹ *JJB Sports PLC v Office of Fair Trading* [2004] CAT 17, at paragraph 204. See also *Argos Limited and Littlewoods Limited v Office of Fair Trading* [2004] CAT 24, at paragraphs 164 and 165.

3.26 In *Burgess v The Office of Fair Trading et al* [2005] CAT 25, a case involving an infringement by a company benefiting from the immunity from penalty under s.40, the CAT held that, in the circumstance of that case, the appropriate standard of proof was the civil standard: '...It seems to us clear from that provision [referring to s.40(8) of the Competition Act 1998] that with smaller undertakings, such as those with which this case is concerned, the priority of the legislature is to bring infringements of the Chapter II prohibition to an end in a timely way, and not to impose penalties until the undertaking concerned has had every opportunity to put its house in order...In those circumstances we see no reason not to apply the civil standard of the balance of probabilities when evaluating the evidence in this case'.¹⁰²

¹⁰² See also the judgment of Munby J in *R (DJ) v Mental Health Review Tribunal* [2005] EWHC 587 (Admin), 11 April 2005, at paragraphs 40 to 42, 47, 57, 75 and 90, citing with approval the Tribunal's analysis of the applicable standard of proof in *JJB and Allsports* (paragraphs 119-120 of the judgment). The issue of the application of the civil standard of proof has also recently been considered by the House of Lords in two cases: *In re B* [2008] UKHL 35 and *Re Doherty* [2008] UKHL 33. The High Court has also recently considered the issue of proof in cases under Art. 81 EC in *BAGS v Amalgamated Racing* [2008] EWHC 1978 (Ch).

4 ASSESSMENT OF THE RELEVANT MARKETS

A Introduction

4.1 Market definition is not an end in itself. Rather, it is a key process for identifying relevant competitive constraints acting on a supplier of a given product or service, thus facilitating the assessment of dominance. It provides a framework for competition analysis and is usually the first step in an assessment of market power.

4.2 This Chapter considers the relevant market definition in this case. It sets out the OFT's approach, taking account of the OFT guidelines¹⁰³ and with reference to relevant past cases that serve as a useful guide when assessing the relevant market definition. The resulting framework for analysis is then applied, to produce a definition of the relevant markets in this case.

B A framework for establishing the market definition

4.3 The following section sets out a framework for the analysis of market definition in this case, with reference to approaches taken in previous competition investigations and to relevant court cases in the bus industry.

i. The hypothetical monopolist test

4.4 In defining the relevant market(s), competition authorities normally use the conceptual framework known as the hypothetical monopolist test.¹⁰⁴ This test therefore forms the starting point for the framework the OFT has used in this case.

4.5 The hypothetical monopolist test, also known as the SSNIP (small but significant non-transitory increase in price) test, supposes that there

¹⁰³ See *Market definition* (OFT403).

¹⁰⁴ The competition law guideline *Market Definition* (OFT403) sets out in more detail how the OFT applies the test (see paragraphs 2.5 to 2.13).

exists a hypothetical monopolist of the 'focal' group of products.¹⁰⁵ The test then asks whether it would be profitable for a hypothetical monopolist to increase the price of the focal product by a small but significant amount (for example five to 10 per cent) above competitive levels for a sustained period of time. If the answer to this is 'yes', the test is complete. The product under the hypothetical monopolist's control is usually the relevant market.¹⁰⁶

4.6 If the answer to this question is 'no', this is typically because a sufficiently large number of customers would either switch some of their purchases to other substitute products (demand side substitution) or decide not to make a purchase. The test then continues, with the hypothetical monopolist assumed to control both the focal product and its closest substitute. The process is repeated, but this time in relation to the larger set of products under the hypothetical monopolist's control.¹⁰⁷

4.7 However, in some situations the pricing strategy would not be profitable because of the responses of other suppliers (supply side substitution). That is, if prices rise, businesses that do not currently supply the product might be able to supply it at short notice and without incurring substantial sunk costs. In these cases, where there are high levels of supply side substitutability, it may be appropriate to take supply side substitution into account.¹⁰⁸

4.8 The OFT's guidance states that: 'The OFT will not factor supply side substitution into the market definition unless it is reasonably likely to take place, and already has an impact by constraining the supplier of the product or group of products in question...If there is any doubt about whether or not to account for supply side substitution when defining the market and calculating market shares, the market will be defined on the

¹⁰⁵ The term 'product' is used for convenience and should be interpreted throughout this Decision to mean good, service or property right.

¹⁰⁶ See *Market Definition* (OFT403), paragraph 2.10.

¹⁰⁷ *Ibid*, paragraph 2.11.

¹⁰⁸ *Ibid*, paragraphs 3.12 to 3.18.

basis of demand side substitutability, and the supply side constraint in question will be considered when analysing potential entry'.¹⁰⁹

- 4.9 It is for the OFT to decide what evidence it uses in order to reach a decision. There is no obligation to conduct a quantitative SSNIP test analysis (or any other specific test).¹¹⁰
- 4.10 Typically, when considering the hypothetical monopolist test, it is not possible to rely on the observed results of an actual five to 10 per cent rise in the price of the focal product above the competitive level, and thus be able to demonstrate in that way the actual effects of such a rise on demand for that product and profitability. Given this, the OFT normally uses the SSNIP test as an analytical framework, and infers what the likely outcome of the test would be based on a qualitative assessment of the information available to it. This is true in this particular case, because insufficient data were available for a statistical SSNIP analysis to be carried out.
- 4.11 As in most cases, the OFT has therefore not undertaken a quantitative analysis of the SSNIP test in this case, but rather has made an assessment, based on the evidence available to it, of the potential for substitution from the focal product. As part of this assessment, it is necessary to consider the extent to which demand side and supply side substitution are likely to occur.
- 4.12 Evidence on demand side substitution from a number of different sources may be considered. For example, if evidence on own price elasticities of demand¹¹¹ is available, this would provide useful information on whether following a price rise in the focal product

¹⁰⁹ Ibid, paragraph 3.18.

¹¹⁰ In *Aberdeen Journals Ltd v Office of Fair Trading*, [2003] CAT 11, the CAT said (at paragraph 258), that '...there is no hierarchy of evidence under the 1998 Act on such issues as market definition. It is for the Director to decide what evidence he considers is sufficient for his decision, and for the Tribunal to decide whether that evidence is sufficient or not'.

¹¹¹ The own price elasticity of demand measures the rate at which demand for a product (such as the focal product) changes when its price goes up or down.

significant numbers of customers would switch their purchases from the focal product to other substitute products.¹¹²

4.13 However, customers may take time to respond to a sustained rise in the price of the focal product. As a rule of thumb, if substitution would take longer than one year, the products to which customers eventually switched would not be included in the same market as the focal product.¹¹³ Products to which customers could switch within a year without incurring significant switching costs¹¹⁴ are more likely to be included in the relevant market. This suggests that short-run elasticities of demand are likely to be more relevant to the assessment of market definition than long-run elasticities.

ii. Recent cases in the same sector

4.14 Recent OFT merger decisions relating to the bus and coach industry include:

- acquisition by Stagecoach Group plc of Highland Country Buses Limited and Orkney Coaches Limited, the OFT's decision on reference under section 22(1) given on 17 October 2008,¹¹⁵
- acquisition by Stagecoach Bus Holdings Limited of Cavalier Contracts Ltd, the OFT's decision on reference under section 22(1) given on 18 September 2008,¹¹⁶
- acquisition by FirstGroup plc of Truronian Limited, the OFT's decision on reference under section 33(1) given on 28 March 2008,¹¹⁷
- acquisition by Go North East of Stanley Taxis, the OFT's decision on reference under section 22(1) given on 18 March 2008,¹¹⁸

¹¹² See *Market Definition* (OFT403), paragraph 3.7.

¹¹³ *Ibid*, paragraph 3.6.

¹¹⁴ From a customer's point of view, switching costs can be defined as the real or perceived costs that are incurred when changing supplier, but which are not incurred by remaining with the current supplier.

¹¹⁵ See: http://www.offt.gov.uk/shared_offt/mergers_ea02/2008/Stagecoach-Orkney.pdf.

¹¹⁶ See: http://www.offt.gov.uk/shared_offt/mergers_ea02/2008/Stagecoach2.pdf.

¹¹⁷ See: http://www.offt.gov.uk/shared_offt/mergers_ea02/2008/FirstGroup.pdf.

- acquisition by Greater Manchester Buses South Limited of A. Mayne & Son Limited, the OFT's decision on reference under section 33(1) given on 10 January 2008,¹¹⁹ and
- acquisition by Arriva of the Darlington local bus services business of Stagecoach Group plc, the OFT's decision on reference under section 33(1) given on 22 August 2007.¹²⁰

4.15 In addition to merger cases, the OFT has previously issued a decision concerning an allegation of predation in the bus industry, in *First Edinburgh/Lothian*.¹²¹ However, in that case the OFT found that First Edinburgh's conduct was not abusive, and it did not reach a conclusion on market definition.

4.16 The Competition Commission (CC) has also reported on a number of mergers in the UK bus industry in recent years, including:

- Stagecoach and Scottish Citylink: A report on the completed joint venture between Stagecoach Bus Holdings Ltd and Braddell Plc in relation to megabus.com, Motorvator and Scottish Citylink, October 2006,¹²² and
- Arriva plc and Sovereign Bus & Coach Company Ltd: A report on the acquisition by Arriva plc of Sovereign Bus & Coach Company Ltd, January 2005.¹²³

4.17 The CC has also reported on mergers involving the acquisition of passenger rail franchises by bus operators. These reports provide relevant information regarding market definition in the bus industry, particularly relating to the potential for substitution between bus and rail services. The most recent such CC reports include:

¹¹⁸ See: http://www.offt.gov.uk/shared_offt/mergers_ea02/2008/Go-North-East.pdf

¹¹⁹ See: http://www.offt.gov.uk/shared_offt/mergers_ea02/2008/GMB.pdf

¹²⁰ See: http://www.offt.gov.uk/shared_offt/mergers_ea02/361227/Arriva.pdf

¹²¹ Decision of the Office of Fair Trading, No.CA98/05/2004, *First Edinburgh/Lothian*, 29 April 2004. See: http://www.offt.gov.uk/shared_offt/ca98_public_register/decisions/lothian.pdf.

¹²² See: http://www.competition-commission.org.uk/rep_pub/reports/2006/fulltext/516.pdf

¹²³ See: http://www.competition-commission.org.uk/rep_pub/reports/2005/fulltext/496.pdf

- FirstGroup plc and the Greater Western Passenger Rail Franchise: a report on the acquisition by FirstGroup plc of the Greater Western Passenger Rail Franchise, 8 March 2006,¹²⁴ and
- FirstGroup plc and the Scottish Passenger Rail Franchise: a report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail Franchise currently operated by ScotRail Railways Limited, June 2004.¹²⁵

4.18 In its written representations on the SSO,¹²⁶ Cardiff Bus claimed, in relation to some of the elements of analysis described in Chapters 4 to 6, that the OFT could not reach different conclusions to those reached in past mergers cases and Competition Commission reports.

4.19 The OFT does not accept this argument. It is important to note that it is necessary to consider each case on its own facts, market context, and with regard to the purpose of the analysis being considered.¹²⁷ The OFT's decisions and Competition Commission reports on merger cases do not have binding precedential value for behavioural investigations such as this case.

4.20 This does not mean that the findings and approach taken in merger cases have no relevance as a guide during a behavioural investigation in the same sector. However, the arguments presented by Cardiff Bus do not call into question any of the arguments set out in the present case, but refer to other relevant markets with other sets of circumstances.

¹²⁴ See: http://www.competition-commission.org.uk/rep_pub/reports/2006/fulltext/510.pdf

¹²⁵ See: http://www.competition-commission.org.uk/rep_pub/reports/2004/fulltext/490.pdf

¹²⁶ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008. See, for example, paragraphs 2.13 to 2.19; paragraph 3.11, and paragraphs 3.15 to 3.31.

¹²⁷ See, for example, *Market Definition* (OFT403), December 2004, footnote 5 and paragraphs 5.7 to 5.9. See also Joined Cases T-125/97 and T-127/97 *The Coca-Cola Company v European Commission*, paragraph 81.

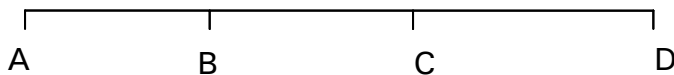
iii. The geographic nature of transport services

4.21 Users of transport services want to travel from A to B, and will typically make their choice on how best to do so on the basis of factors such as the distance, whatever transport options are available to them (which can vary by individual) and their perceptions of the trade-offs in time, convenience and cost of those options. The nature of transport services is inherently geographic, because consumers want to travel from an origin to a destination. In this respect, the OFT's analysis considers two focal products: single flows and the network.

(a) Flow-by-flow analysis

4.22 Given that consumers want to travel from an origin to a destination, the CC's approach to market definition in transport cases has typically been based on individual point-to-point journeys, or flows. For example, in the *Stagecoach/Scottish Citylink* case, the CC stated that: '...the CC's approach to market definition in a transport merger inquiry is usually to conduct a competitive analysis by considering competition on the various point-to-point journeys on which the main parties both provided services'.¹²⁸

4.23 Each possible point-to-point journey between stops is called a flow. There can be many flows on any given route.¹²⁹ For example, consider the route below, with four stops labelled A to D.



¹²⁸ *Stagecoach and Scottish Citylink: A report on the completed joint venture between Stagecoach Bus Holdings Ltd and Braddell Plc in relation to megabus.com, Motorvator and Scottish Citylink*, 23 October 2006, paragraph 4.5.

¹²⁹ In this Decision the term 'route' refers to the journey from the start to the end points of a scheduled public transport service, taking in all of the scheduled stops for picking up and setting down passengers. For example, in the diagram above the route is A to D, via B and C.

- 4.24 Each possible point-to-point journey between two stops on a route is a 'flow'. In general, there will be $N \times [N-1]$ flows on any given route, where N is the number of stops. Thus, in the above example, flows include journeys AB, BC, CD, AD and all other combinations in between, with a total of 12 flows. Note that a journey from the start and end points of the route, such as AD, is also a relevant flow.
- 4.25 Taking into account the CC's approach, the OFT considers that a flow-by-flow analysis is a suitable starting point for considering the market in this case.
- 4.26 However, while point-to-point flows are the starting point for the analysis of competition, for the purposes of assessing the relevant markets it is relevant to consider the route level and the network level. None of the key parameters of competition such as price, frequency and bus quality vary on a flow level and all are parameters that can be chosen at the route or network level.
- 4.27 As set out in Chapter 2, Cardiff Bus sets fares on the basis of a concentric zonal system. It does not set different prices for different routes or prices on each individual flow. This is for the logistical reason that setting prices on individual flows or routes would lead to a complex pricing structure that would be confusing for customers.¹³⁰
- 4.28 Bus frequency and bus quality can be varied by route but not by individual flows on a route. Looked at simply, a hypothetical monopolist bus operator on a particular flow would also have to be a hypothetical monopolist for all routes serving that flow.
- 4.29 As a result while in this Decision the starting point of market definition at a geographic level is the individual flow, these flows are aggregated to routes for the purposes of assessing the relevant markets. As is

¹³⁰ A research paper produced by the TAS partnership, when advising Cardiff Bus on an appropriate fare and ticketing strategy, listed simplicity and transparency as key principles that should be adopted in the charging system. See: *Cardiff Fares & Ticketing Strategy, A report to: Cardiff Bus*, TAS (2006), paragraph 1.2.1. This report is referred to in this Decision as the 'TAS report'.

demonstrated in Chapter 5, while the competitive parameters for individual operators do not vary according to the flow, the extent of competition on a flow will vary, according to the number of operators on the routes serving that flow. As a result when assessing Cardiff Bus' market position the OFT has looked at the individual flows that form part of the relevant routes.

(b) Network analysis

4.30 Fare-paying passengers can usually buy two types of tickets. The first is a ticket that is related to a particular route or part of a route (in other words, a flow), and is usually a single ticket. The second is a ticket that is related to a bundle of interrelated (interconnected, overlapping or adjacent) routes in a particular area (such as return tickets,¹³¹ daily, weekly, monthly and yearly network tickets). Consideration of a network market therefore captures the behaviour of passengers who buy network tickets.

4.31 In *First/Scotrail*¹³² the CC stated that the scope of the network market can be defined in relation to a particular operator's service, or in relation to a wider geographic area, including other operators' services in that area.

4.32 Bundled products, such as return and network tickets, will typically be offered at a price no more than the sum of individual flow tickets (Tables 5 and 6 in Chapter 2 list Cardiff Bus' single and return fares at the time). The relative attractiveness of network tickets to consumers will depend on the number and profile of journeys they make on average. For instance, weekly network tickets are likely to be attractive

¹³¹ A return ticket is a bundle of two flows – for example from A to B and B to A.

¹³² *A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited*, Competition Commission, June 2004, footnote 9, page 12.

to regular users travelling to and from work and thus typically making at least ten journeys a week.¹³³

- 4.33 In this case, therefore, market definition is considered on the basis of flows as well as on a wider network to capture the possibility of passengers switching away from the focal product in the event of a SSNIP on fares for individual flows and on network fares.
- 4.34 In its written representations on the SSO,¹³⁴ Cardiff Bus stated that the OFT had incorrectly defined the product market by including a network analysis, and that the focal product should be: '...the routes subject to the alleged predation and the wider geographic market to the extent there are supply side substitutes'.
- 4.35 The OFT rejects the suggestion that it is not relevant to consider a network market. Certain parameters of competition are determined on a route level basis (for example, bus frequencies). By contrast others are determined at the network level (for example, bus fares).¹³⁵
- 4.36 Furthermore, to the extent that Cardiff Bus' conduct on the white service routes affected its position on the network market, in that 2 Travel's presence could have acted as an effective constraint on Cardiff

¹³³ Chapters 6 and 7 discuss the ability of Cardiff Bus to adjust the relative attractiveness of network tickets.

¹³⁴ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, at paragraph 2.13.

¹³⁵ See Stagecoach and Scottish Citylink: A report on the completed joint venture between Stagecoach Bus Holdings Ltd and Braddell Plc in relation to megabus.com, Motorvator and Scottish Citylink, 23 October 2006, paragraphs 4.16: 'Networks may also be relevant to passengers who benefit from the availability of such network tickets. On the demand side, the same considerations apply to passengers who buy network tickets as apply to passengers who buy flow- or route-specific tickets, namely that they will not use other networks in response to a small price rise on one network unless these other networks include their origin and destination and the same set of flows or routes they want to use. This suggests that for this group of passengers the relevant market would be a network'. In its response to the OFT's Further Notice, Cardiff Bus claimed that the '...contention that bus fares are determined at a network level is not true and is unsupported on the facts of this case, as demonstrated by the differing fares of the white and normal services' (Source: Cardiff Bus' response to the OFT's Further Notice, dated 10 November 2008, paragraph 12). The OFT rejects this argument. The white service and normal bus fares **were** set at a network level on a zonal basis, and did not vary by flow or route.

Bus' prices for its normal bus services, it is relevant to consider the network market.¹³⁶ Therefore, the relevant markets need to be defined with reference to the most important sources of competition for Cardiff Bus, and not simply be limited to where 2 Travel was present.

iv. Approach to demand and supply side substitution

4.37 A market definition typically reflects two dimensions: a product and a geographic area (see paragraph 3.10). As described in Section Bi above, both these dimensions should be assessed on the basis of demand side substitutability, while considering whether supply side substitutability should also be taken into account. This analytical framework applies on a flow and a network basis (see Section Biii above). It is convenient to represent this framework using a two-dimensional matrix:

		Dimension	
		Product	Geographic
Substitutability	Demand side	Cell 1	Cell 2
	Supply side	Cell 3	Cell 4

4.38 However, the geographic nature of both focal products (flows and the network) allows the OFT to simplify its analysis:

- For the assessment of the geographic dimension, the OFT can rule out demand side substitutability (Cell 2), on the grounds that a consumer would not substitute their chosen origin-destination journey for a different one.
- The assessment of the product dimension refers to the substitutability between bus services and alternative modes of private and public transport.¹³⁷ In this respect, it is reasonable to

¹³⁶ See Decision No. CA98/14/2002, *Aberdeen Journals Limited*, 16 September 2002, paragraphs 19 to 20.

¹³⁷ Here, commercial and tendered bus services can be classified within the same broad mode of transport. However, the extent to which tendered bus services are supply side substitutes for commercial (including no-frills) services is considered in **Annexe 2**, when assessing the possibility of supply side substitutability for the purposes of defining the relevant geographic market.

rule out supply side substitution from different modes of transport (Cell 3). For instance, it seems unlikely that a taxi firm could, in the short term and without substantial sunk costs, become a bus service operator.

- 4.39 Therefore, in defining the market, the product dimension coincides with the extent to which there is demand side substitutability (Cell 1), which in practice reflects inter-modal consumer choice on a flows and network basis; and the geographic dimension is captured by consideration of the possibility of supply side substitution (Cell 4). However as discussed in paragraphs 4.26 to 4.36 above, the geographic dimension is also affected by the extent to which there are common parameters of competition at the flow, route and network level.
- 4.40 In the following analysis, the OFT first describes the two focal products on a flow and route level and on a network basis (Section C). In Section D, the OFT then assesses the extent of demand side substitutability, which, as explained in this Section, captures the product dimension of market definition. Similarly, in Section E and in Annexe 2, the OFT analyses the possibility of supply side substitution from within the same mode of transport, in order to assess the geographic dimension of the relevant markets.

C The focal products

- 4.41 As explained in Section Biii above, the OFT considers the two focal products based on a flow and route level and a network analysis. This Section describes them in terms of their inherent geographic features. In particular, the description on a flow and route level relates to the routes on which 2 Travel and Cardiff Bus ran their no-frills services; and the description of the network is based on the network service provided by Cardiff Bus.

i. Relevant routes and flows

4.42 At the relevant time in this case, Cardiff Bus and 2 Travel operated no-frills bus services serving the following routes:¹³⁸

- Cardiff Bus services 17/18/117 and 2 Travel service 217: Cardiff Central Bus Station to Ely via Westgate Street, Cowbridge Road East, Cowbridge Road West, Amroth Road, Bishopston Road, Heol Trelai, Green Farm Road and Grand Avenue.
- Cardiff Bus services 44/45/X46/144 and 2 Travel service 244: Cardiff Central Bus Station to St Mellons via Wood Street, St Mary Street, Greyfriars Road, Dumfries Place, Newport Road, New Road, Greenway Road, Aberdaron Road, Hendre Road, Crickhowell Road, Willowbrook Drive.
- Cardiff Bus services 49/50/150 and 2 Travel service 250: Cardiff Central Bus Station to Llanrumney via Wood Street, St Mary Street, Greyfriars Road, Stuttgarter Strasse, Newport Road, Ball Road and Burnham Avenue, Countisbury Avenue to Llanrumney Roundabout.
- Cardiff Bus services 60/61/62/162 and 2 Travel service 262: Cardiff Central Bus Station to Pentrebanne via Westgate Street, Cowbridge Road East, Western Avenue, St Fagans Road, Plasmawr Road, Pentrebanne Road, Beechley Drive, Firs Avenue.

4.43 Maps of the Cardiff Bus no-frills white services for these four routes are set out below (Figures 1 to 4). As can be seen from these maps, the relevant routes (and hence also the relevant flows) lie close together on two main corridors out of the city: east and west. The physical proximity of these routes suggests that the conditions for demand side substitution are likely to be similar across many of the flows.

4.44 As noted in paragraph 2.35, 2 Travel also registered a fifth service, the 258, with the Traffic Commissioner, but due to resource shortages

¹³⁸ Note that these are only the stops listed in the relevant timetables. There are additional minor stops which were not included in the timetables. See for example the *Cardiff Bus, Rail and Tourist Map & Guide*, June 2003.

never operated it. A map of service 57/157/158 was not available and Cardiff Bus did not provide the OFT with a timetable for route 157/8. However contemporaneous documents¹³⁹ indicate that these services followed the equivalent projected 2 Travel route for its service number 258:

- Cardiff Bus services 57/157/158 and 2 Travel service 258: Cardiff Central Bus Station to Pentwyn via Glyn Coed Road, Circle Way East, Llanedeyrn Drive Shops, Circle Way West, Llanedeyrn Road, Pen-y-lan Road, Wellfield Road, Albany Road, Richmond Place, Dumfries Place, Greyfriars, Westgate Street.

¹³⁹ See for example *Cardiff Bus Traffic Notice*, 14 April 2004.

Figure 1: Cardiff Bus routes 17, 18 and 117

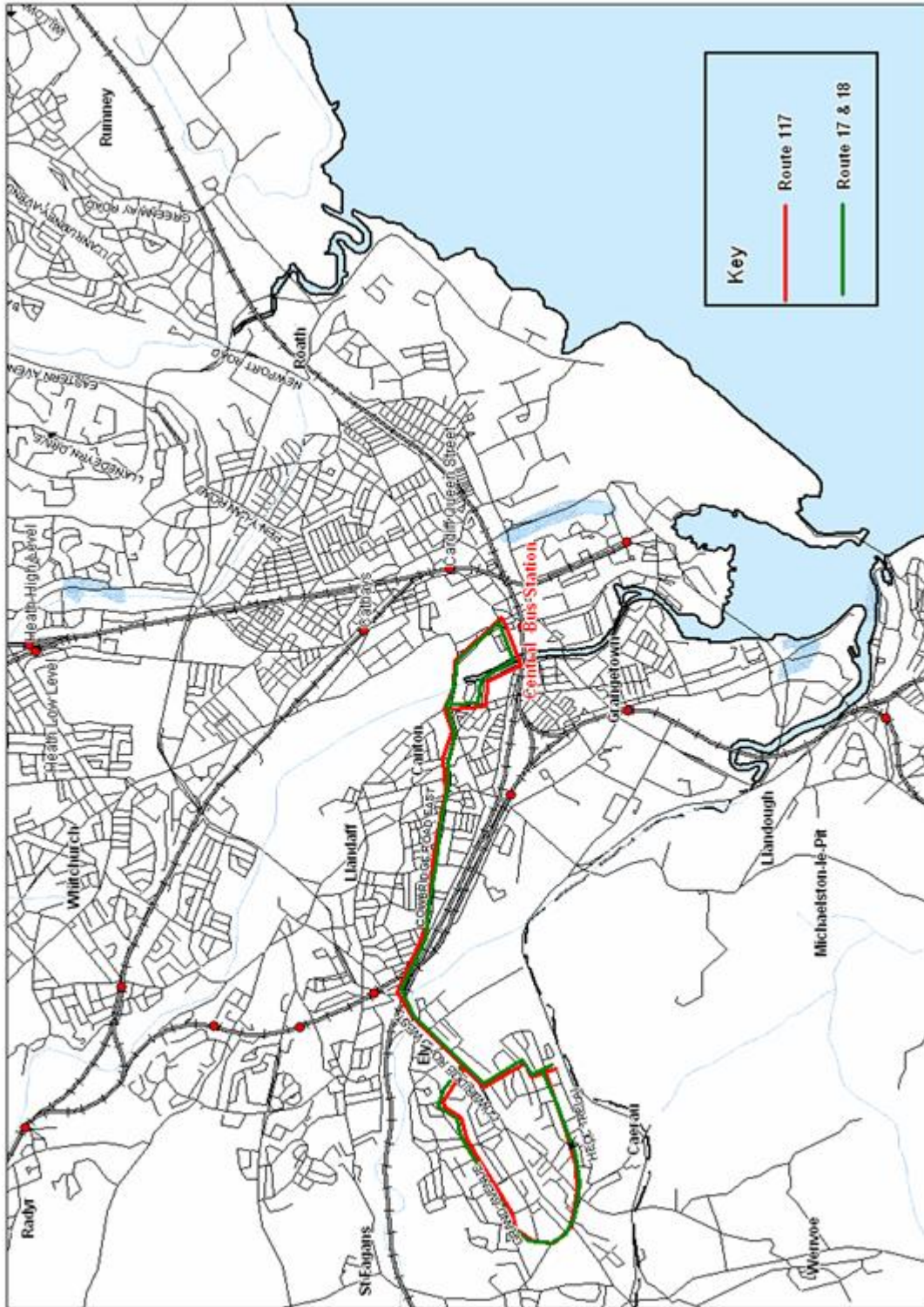


Figure 2: Cardiff Bus routes 44, 45, X46 and 144

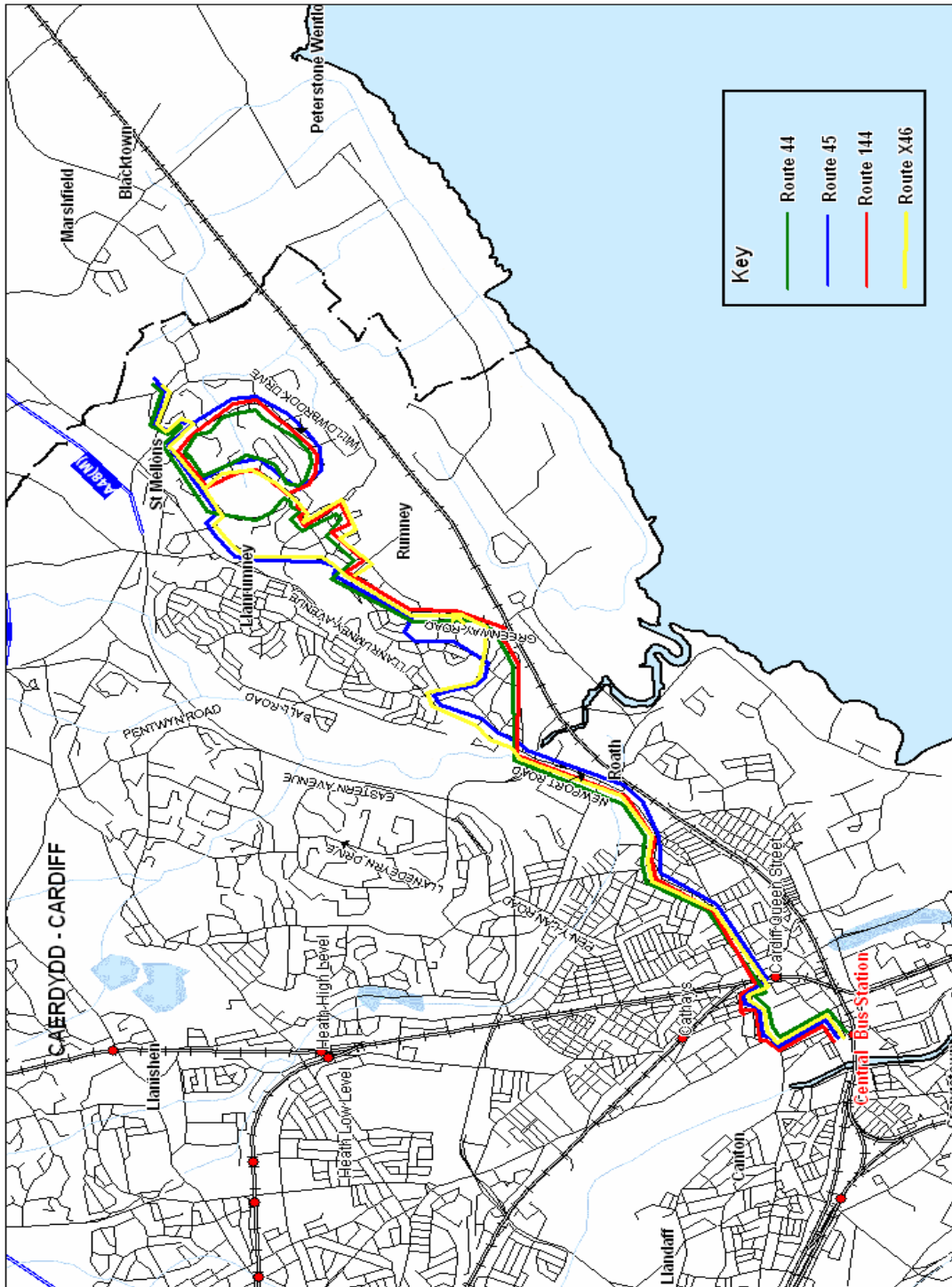


Figure 3: Cardiff Bus routes 49, 50 and 150

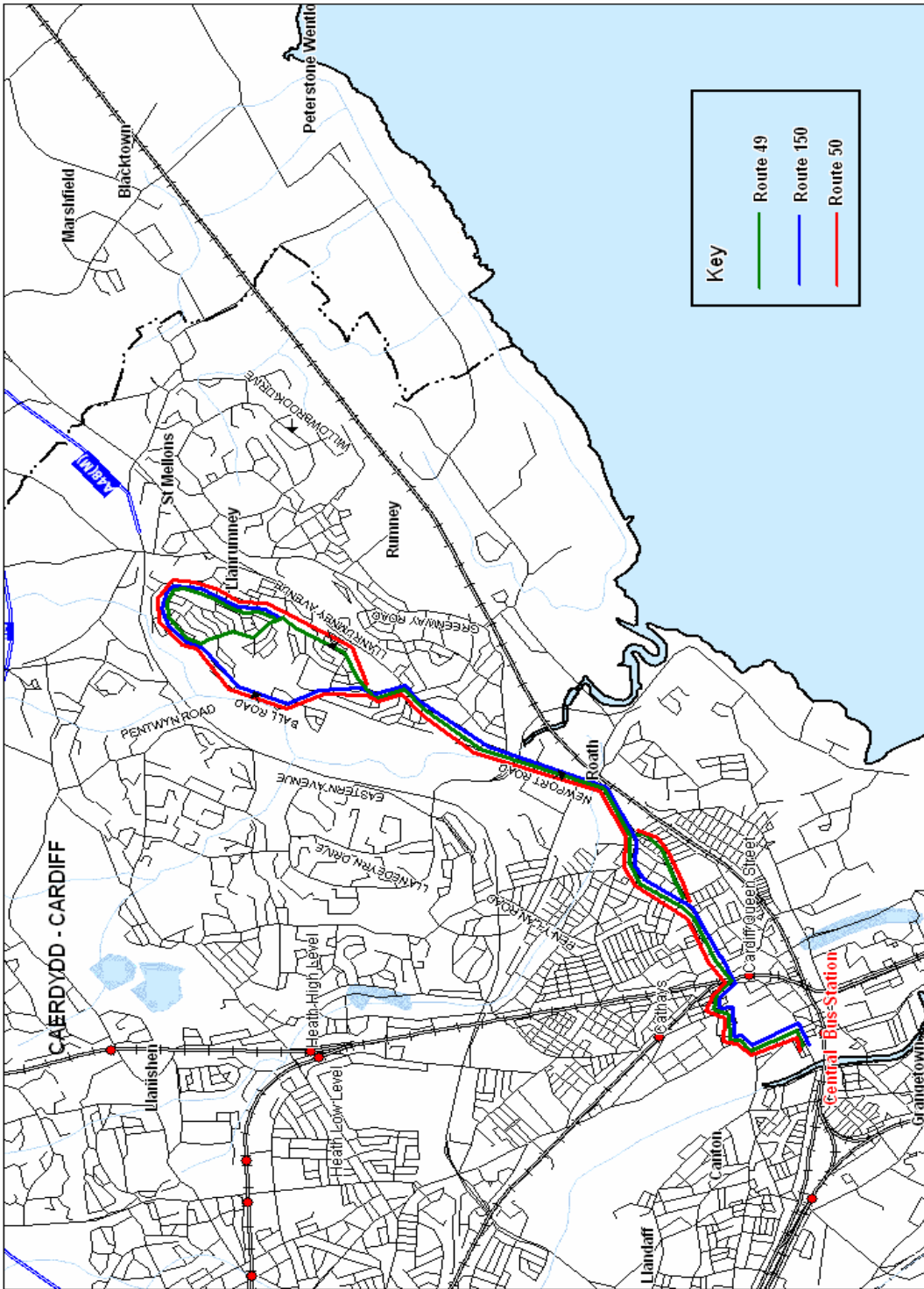
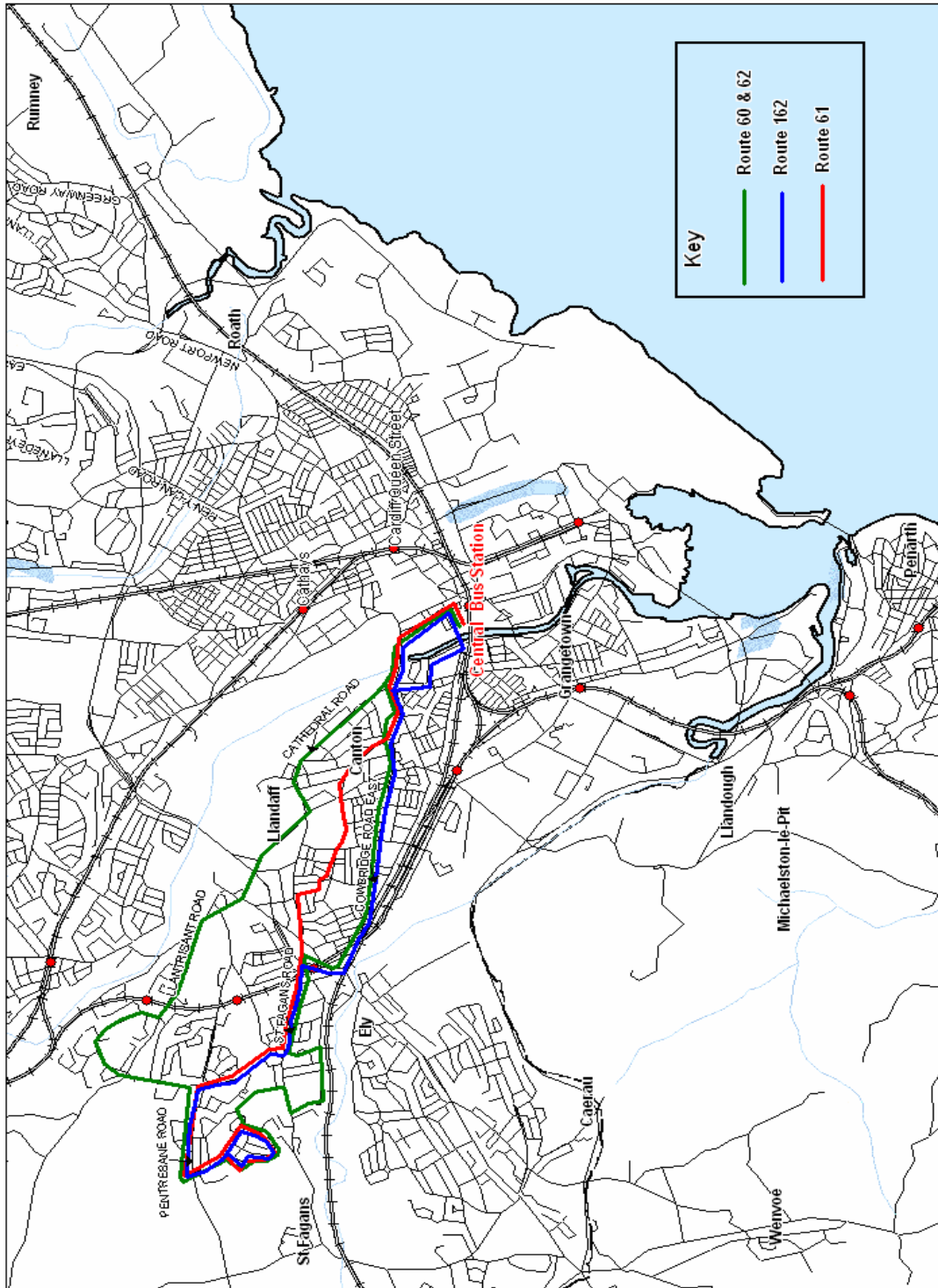


Figure 4: Cardiff Bus routes 60, 61, 62 and 162

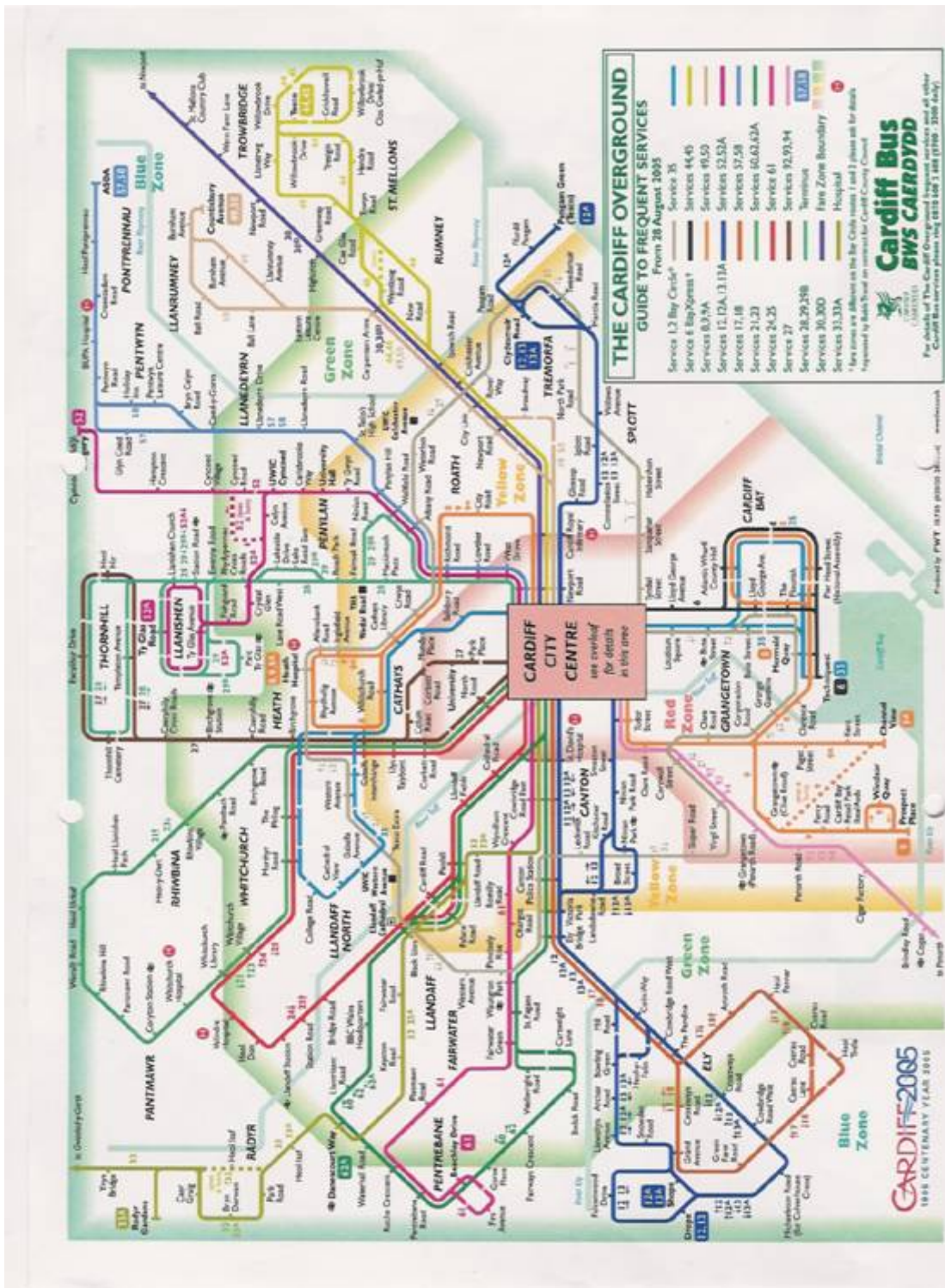


ii. The network

- 4.45 As discussed in Section Biii above, in addition to the flow and route basis described above, the OFT considers it appropriate to assess the competitive constraints facing Cardiff Bus on a network market basis in the Cardiff County area, to take account of passengers who purchase network tickets.
- 4.46 Cardiff Bus operates around 42 frequent services within its network in Cardiff, as shown by the 'Cardiff Overground' map for 2005 (see Figure 5). Cardiff Bus offers its own travelcards, known as the 'day to go' and 'week to go', which allow passengers unlimited travel on its network.¹⁴⁰
- 4.47 Where an operator offers a network of services as Cardiff Bus does within Cardiff County, and offers network tickets, passengers will benefit not only from time savings in the purchase of tickets but also from a wider choice of destinations, greater flexibility in timings of journeys and savings on the cost of additional journeys. The larger the network and acceptability of tickets the greater the likely benefits to passengers.

¹⁴⁰ See Cardiff Bus' guide to bus tickets and fares for Cardiff, Penarth, Barry and the Vale from 16 April 2006.

Figure 5: Cardiff Bus 'Overground' map (August 2005)



Source: Cardiff Council website.

D The relevant product market

4.48 As discussed in Section B, the inherently geographic nature of transport services implies that the assessment of the relevant product market requires an assessment of demand side substitutability - in particular, inter-modal substitution. This Section considers demand side substitutability for the two focal products described above: no-frills bus services and network services in Cardiff. However, the OFT's analysis focuses on a flow and route basis, because the same arguments apply, and the extent of demand side substitution would be no less than on a network basis. In this case the focus is on Cardiff Bus' no-frills white services.

i. Potential substitutes for no-frills bus services in Cardiff

4.49 The following potential substitutes for the no-frills services are considered in this analysis:

- (a) 'normal' bus services,
- (b) tendered bus services,
- (c) interurban bus services,
- (d) cycling and walking,
- (e) cars and taxis,
- (f) urban train services, and
- (g) interurban train services.

(a) 'Normal' bus services

4.50 Cardiff Bus stated¹⁴¹ that in its view the differences between no-frills and normal bus services are that: '...A "No Frills" service would typically involve operating with the driver without uniform, older vehicles in a

¹⁴¹ Letter dated 15 September 2006, responding to the OFT's section 26 notice dated 17 August 2006.

style that indicates "cheap and cheerful", reduced frequency and limited areas of operation, operating hours limited to core hours Monday to Friday, and no additional features such as CCTV. This is to be contrasted with the normal services which have a strong brand image, high quality vehicles, uniformed staff, CCTV, strong marketing and promotion, high frequency, and services available early to late seven days a week'.

- 4.51 In this case, Cardiff Bus introduced and operated its no-frills white services alongside its normal bus operation, using vehicles from its reserve fleet of Optare Metrorider Clipper midibuses. These vehicles were older than those used by Cardiff Bus on its normal services. They were not branded as Cardiff Bus services and they charged lower fares than normal Cardiff Bus services (see paragraph 2.52).
- 4.52 As noted in paragraph 2.33, the no-frills services introduced by 2 Travel mirrored some existing normal services provided by Cardiff Bus. Cardiff Bus began running its no-frills white services on those same routes. This suggests that on the demand side a significant proportion of passengers wishing to travel between points on the relevant routes would regard the no-frills and normal services as substitutes.
- 4.53 In practical terms, passengers could, if they wished to, switch from the normal Cardiff Bus services onto the white services, as they were operating on largely the same routes.¹⁴² In addition, tickets were interchangeable between the white and normal services: a return ticket purchased on a white service could be used on a normal service on the return leg of the journey, and vice versa.¹⁴³

¹⁴² The OFT recognises that there may be some asymmetry in the passenger responses between normal and no-frills services. An increase in the price of no-frills services may lead to a proportionately larger number of passengers switching to normal services whereas an increase in the price of normal services may lead to a much smaller proportion of passengers switching to no-frills services. However, because the focal product in this case is the no-frills services, it is the former response not the latter that is relevant for market definition.

¹⁴³ White bus fare codes effective from 19 April 2004, submitted by Cardiff Bus to the OFT in response to a section 26 notice dated 26 May 2005.

4.54 On the basis of the evidence before it, therefore, the OFT concludes that normal and no-frills bus services are demand side substitutes on the relevant routes and flows.

(b) Tendered bus services

4.55 Both commercial (normal and no-frills) and tendered services can provide transport services along a route to customers. As noted in Chapter 2, the main difference between commercial and tendered services is the way in which they are financed. On a commercial service, the bus operator will be seeking to earn sufficient revenue from carrying passengers to cover the costs of the service.¹⁴⁴ With regard to tendered services, section 63(5)(a) of the Transport Act 1985 provides that a local authority can enter into an agreement to subsidise services where the service in question would not be provided without subsidy.¹⁴⁵

4.56 The Code of Practice on Tendering¹⁴⁶ states that: '...the terms of authorities' subsidy powers need not constrain authorities to subsidising services only along routes where no commercial services whatsoever will be available'. Local authorities have to assess how far registered services meet the transport requirements identified in their particular jurisdiction.¹⁴⁷

4.57 Taking into account the Code of Practice on Tendering, local authorities are likely to subsidise services on routes with different origins and destinations compared to commercial services, because these routes may not be commercially viable for private operators to provide (such as rural routes). Where they do subsidise routes that overlap with commercial services, it is likely to be at different times of the day.

¹⁴⁴ Either directly, through charging a fare to the individual passenger, or by deriving income from a multi-operator travelcard scheme for providing services to the passengers.

¹⁴⁵ In *Arriva/Sovereign*, the CC noted in relation to tendered bus services that: '...competition for tendered services takes place in the bidding for the contracts and not 'on-the-road': it is competition for the market and not competition in the market'. Arriva plc and Sovereign Bus & Coach Company Ltd, CC Report, January 2005, paragraph 4.11.

¹⁴⁶ Contained in the Annexe to Local Authority circular 5/85, 1985.

¹⁴⁷ For example, the local authority may subsidise additional weekend or evening services on a route that operates on a commercial basis during peak hours Monday to Saturday.

Consequently, tendered and commercial services are unlikely, in most instances, to be demand side substitutes.

- 4.58 In theory, some bus passengers could, if faced with an increase in fares on commercial services, potentially choose to alter the time of their journey on a route in order to use an alternative tendered service (if available). However, for many bus passengers this would not be practicable, for example if the purpose of the journey was related to work times, or if they had to complete a specific task at a particular time (such as shopping while children were at school). In addition, as discussed in section Biv, where tendered services do not serve the same origin and destination points as commercial services, demand side switching will be unlikely.
- 4.59 The past practice of the CC, as set out in its published reports, has been to exclude tendered services from the competitive analysis, or, where appropriate, to consider them separately. In its SO and SSO, therefore the OFT considered that in this case, on the basis of demand side substitution, tendered services were not in the same market as commercial services (whether normal or no-frills). This is consistent with the CC's view in *Arriva/Sovereign*.
- 4.60 However, in its written representations on the SSO,¹⁴⁸ Cardiff Bus stated that the product market should include tendered services because there were some overlapping services where passengers could choose to travel on a commercial or a tendered service. The OFT notes that commercial services and tendered services have distinct features such that the competitive constraint posed by a tendered services is not equivalent to that of the same service provided on a commercial basis. However, to the extent that they serve the same flows at similar times

¹⁴⁸ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, Executive Summary.

they are demand side substitutes and should be included in the relevant market.¹⁴⁹

(c) Interurban bus services

- 4.61 For the purposes of this Decision, urban bus services are those which mainly serve destinations within a single urban area, for example, within Cardiff. The relevant Cardiff Bus and 2 Travel services in this case were urban services. Interurban services are those which connect two or more distinct urban areas (such as Swansea and Cardiff), including long distance services.
- 4.62 From the passenger's perspective, interurban and urban bus services will only be demand side substitutes where they enable passengers to travel to their chosen destination. Interurban buses will typically serve passengers travelling from town A to town B, but may also have a number of stops within the towns. Whether interurban routes should be included in the market on the demand side will depend on the degree to which they serve the same stops as urban services within the relevant urban area.
- 4.63 There are a number of interurban services running into Cardiff (see, for example Table 8 in Chapter 5). In Cardiff, the interurban services generally stop at a number of locations within the city itself. For example, the number 30 operated by Newport Transport Limited, which connects Newport and Cardiff, serves eight bus stops within a two mile radius of Cardiff Central Bus Station.¹⁵⁰ On these urban stops, the interurban services will be directly competing for passengers with the urban services.
- 4.64 National Express also operates a long distance service into Cardiff. However, this does not offer any stops within the city, with the next

¹⁴⁹ This excludes dedicated tendered schools services, because the general public could not switch to these in response to a SSNIP in bus fares on other bus services.

¹⁵⁰ Letter from Newport Transport dated 9 December 2005, in response to the OFT's section 26 notice dated 24 November 2005. See also *Cardiff Bus, Rail and Tourist Map & Guide*, June 2006.

stop out of Cardiff being Newport.¹⁵¹ Because there is no overlap with the stops served by urban services, long distance services such as these are not considered to be demand side substitutes for urban services.

4.65 The CC has not in the past made any distinction between urban and interurban services. On the available evidence the OFT concludes that urban and interurban services are demand side substitutes to the extent that they serve the same flows.

(d) Cycling and walking

4.66 Cycling and walking may provide effective alternatives to very short bus trips, and can be combined with public transport such as interurban rail services for longer trips.

4.67 A report produced in 2004 by TRL¹⁵² found that short bus journeys (with low fares) and long journeys (with higher fares) were more price elastic than medium length journeys. This suggests that, for short journeys, cycling and walking could be a substitute to local bus services for certain segments of the population,¹⁵³ such as young commuters, although it may be less practical in the case of older people or passengers travelling with young children.

4.68 The OFT considers that the journeys of the majority of commuters and shoppers are likely to fall into the middle category, where demand is less price elastic. In a public survey carried out for Cardiff Bus, of those respondents expressing a view over 90 per cent said on their usual journey they normally covered two or more fare zones¹⁵⁴ when they

¹⁵¹ Letter from National Express responding to the OFT's section 26 notice, dated 24 November 2005. National Express was picking up and dropping off passengers at Cardiff University in addition to Cardiff Central Bus Station, but not selling tickets for travel solely between the University and Bus station.

¹⁵² *The demand for public transport: a practical guide*, TRL Limited, 2004, TRL593, section 6.10.1, page 61.

¹⁵³ However, the Department for Transport (DfT) reports that walking and cycling have generally declined in recent years, in terms of both number of stages and distances walked or cycled. See the DfT's *Transport Trends: 2007 Edition*, section 8.1, page 102.

¹⁵⁴ Figure 5 shows these zones.

travelled on Cardiff Bus services, and the largest proportion (44 per cent) said that they travelled across all four fare zones.¹⁵⁵

- 4.69 The city centre area contains many stops concentrated in a small area (see Figure 9 in Chapter 5). For passengers whose journey involves transferring onto a connecting bus service in the city centre area, it may be reasonable to assume they would walk between adjacent stops to catch the connecting service. However it is unlikely that walking will be an alternative for their entire journey, especially given the high proportion (90 per cent¹⁵⁶) of bus users who said that their usual journey normally covered two or more fare zones – see paragraph 4.68.
- 4.70 There is also likely to be a significant seasonal aspect to cycling and walking. For example, during the winter it may be less attractive to walk or to cycle than in the summer months. Therefore, for 90 per cent of passengers, it is unlikely that walking or cycling will be an attractive alternative to the bus because of distance, whilst for many of the remaining 10 per cent of passengers these other factors make switching unlikely.
- 4.71 The evidence above suggests that insufficient numbers of consumers would switch to cycling or walking in response to a small but significant non-transitory increase in bus fares above the competitive level to make such a price rise unprofitable. The OFT also notes that the CC has also not previously included cycling or walking in the market definition in transport merger cases. Overall, on the available evidence the OFT considers that cycling and walking do not exert a sufficient competitive constraint on bus journeys to be included in the relevant market.

¹⁵⁵ Cardiff Bus' fares are structured by the distance travelled by the passenger. See paragraph 2.52 and the Overground map (Figure 5). Of those responding to user consultation conducted on behalf of Cardiff Bus, 40 per cent were unsure how many zones they covered. Of the remainder, eight per cent travelled one zone, 22 per cent covered two, 26 per cent covered three zones, and 44 per cent covered four zones. OFT calculation based on data contained in *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003, Q10.

¹⁵⁶ This assumes that those respondents who were unsure how many zones they covered took equally distributed journeys (in terms of zones crossed) to those that did know how many zones they crossed.

(e) **Cars and taxis**

4.72 In general, bus operators considered that they competed with private cars, although there was less agreement over the extent to which taxis were substitutes for buses.

4.73 Cardiff Bus told the OFT¹⁵⁷ that: '...customers have a choice of transport, with the result that buses compete with trains and taxis, and with regards to commuters also compete against the private car...The market should be viewed in the context of the metropolitan area and should include all other forms of transport that customers have access to (i.e. trains, taxis and cars)'. In its Mission Statement,¹⁵⁸ Cardiff Bus states that it aims to: '...offer a credible alternative to the private car for most journeys'.

4.74 Other third parties echoed this view in respect of competition from cars, but generally took the view that taxis were less close substitutes:

- **First** told the OFT¹⁵⁹ that, in its view, the biggest competitor to any form of public transport was the car. It was unsure of the level of taxi usage in Cardiff, but stated its opinion that taxis served a different market, which placed a higher emphasis on convenience.
- **Stagecoach** took the view¹⁶⁰ that the closest competitive constraints on buses came from cars, followed by trains and taxis in that order. It thought that taxis in Cardiff generally served the main railway station and tourists visiting Cardiff, although late at night taxis may compete on convenience with buses.
- **Shamrock Travel** told the OFT¹⁶¹ that in terms of cars, congestion was very bad in Cardiff but that parking was cheap. It stated that taxis were rarely used because of their relative expense.

¹⁵⁷ Letter to the OFT, responding to the OFT's section 26 notice, dated 17 August 2006.

¹⁵⁸ See Cardiff Bus, *Achieving the Vision through Partnership 2005-2009*, page 16.

¹⁵⁹ Agreed note of meeting on 3 August 2006.

¹⁶⁰ Agreed note of meeting on 4 August 2006.

¹⁶¹ Agreed note of meeting on 3 August 2006.

- **Bebb Travel** was unable to provide a view on the extent to which private cars offered a substitute to buses. However, it stated¹⁶² that users of buses tended to be from low income groups and were not natural users of taxis.

- 4.75 The CC has in previous cases given extensive consideration to whether cars impose a competitive constraint on public transport. For example, in the *Scotrail* inquiry, the CC commissioned OXERA to summarise available studies on bus and rail elasticities. This study¹⁶³ found that short term bus usage elasticities are between -0.35 and -0.5. This suggests that bus passengers are generally price insensitive. A hypothetical monopolist bus company in such circumstances could, therefore, profitably raise prices by five to 10 per cent, because switching to other transport modes, including cars, would not impose a sufficient constraint. The elasticity findings of the OXERA study therefore support the case for a narrow market definition.
- 4.76 The CC found in the *Scotrail* inquiry that cars did not provide effective competition to public transport on any of the flows in question in that inquiry. In subsequent cases¹⁶⁴ it has referred to the OXERA study and, after considering other factors such as the characteristics of bus and car users, has excluded cars from the relevant market.
- 4.77 In addition, the TAS report¹⁶⁵ prepared for Cardiff Bus in 2006 used a bus fare elasticity estimate of -0.4, which is consistent with the estimates presented above. In that instance, Cardiff Bus appears to have accepted this estimate.
- 4.78 Like the CC, the OFT has also found in previous cases that cars do not provide a sufficient constraint on bus services to be included in the same market. For example, in the OFT's decision in *First*

¹⁶² Agreed note of meeting on 3 August 2006.

¹⁶³ See *FirstGroup plc and the Scottish Passenger Rail franchise: A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited*, Competition Commission, June 2004, Appendix D.

¹⁶⁴ See, for example, *Arriva plc and Sovereign Bus & Coach Company Ltd*, CC Report, January 2005, paragraphs 4.15 to 4.25.

¹⁶⁵ See the TAS report, paragraph 3.3.1.

Edinburgh/Lothian,¹⁶⁶ private cars were not considered to be a sufficiently close substitute for commercial bus services. This was principally because many bus passengers do not have access to cars or could not switch to using a car for their particular journey, for example, because of a lack of parking facilities at their destination. The decision concluded that although rising bus fares might cause some people to use cars instead, it would either take time or a very large increase in fares before a sufficient number of consumers would switch. However, the OFT did not conclude on the definition of the relevant market in that case.

4.79 A similar view was expressed in *Arriva v Sovereign* which states in relation to cars:¹⁶⁷ 'Over the past 20 years, for example, bus fares have increased in real terms by some 40 per cent, whereas the inflation-adjusted cost of using a private car has been broadly unchanged. Although there has been a shift in demand from public to private transport in this period, to a large extent this appears to reflect other factors (as shown in the low own-fare elasticities of buses), in particular the extent to which rising real incomes have increased car ownership and usage'.

4.80 It is also important to note that the correct application of the hypothetical monopolist test, in this case, is not whether there is switching **from cars to buses**, but rather whether in response to an SSNIP in bus fares users switch **from buses to cars**. The low bus elasticities suggest, at least in the short run, that a sufficient enough number of passengers would not switch from buses to cars, making a SSNIP on bus fares profitable.

4.81 Although, therefore, the Government and bus operators may have policies aimed at encouraging people out of cars and onto buses (for example, as noted in paragraph 4.73), the hypothetical monopolist test does not consider switching in this direction. In addition, these policies

¹⁶⁶ Decision No. CA98/05/2004, 29 April 2004.

¹⁶⁷ *Arriva plc and Sovereign Bus & Coach Company Ltd*, CC Report, January 2005, paragraph 4.15.

often take a longer-term view and may have only a limited impact in the short-term.

- 4.82 A report by NERA for the OFT (the 'NERA Report')¹⁶⁸ indicates that bus users tend either to come from non-car owning households or tend not to have a car available as an alternative to using the bus at the time at which they are travelling.¹⁶⁹
- 4.83 In relation to taxis, the NERA report also notes that taxis are not particularly close substitutes for passengers without access to a car because the substantial price differential for most journeys in favour of buses means that taxis are only a close substitute for a small proportion of bus journeys.
- 4.84 The NERA report concluded, in respect of its product market definition, that: 'In the absence of close substitutes (other, perhaps, than to walk on very short journeys), the market demand for bus travel is widely regarded as moderately or even highly price inelastic, so that prices and service quality outcomes are determined by the extent of actual or potential competition within the industry'.¹⁷⁰
- 4.85 In general, therefore, although cars and taxis provide a similar service to consumers as buses in terms of transport from an origin to a destination, the extent to which they act as demand side substitutes for buses appears to be limited. Key factors limiting the extent of substitution, include:

¹⁶⁸ *The Effectiveness of Undertakings in the Bus Industry*, prepared for the OFT by National Economic Research Associates (NERA), Research paper 14, December 1997. This report is referred to in this Decision as the 'NERA report'. Available at: http://www.offt.gov.uk/shared_offt/reports/transport/oft200.pdf.

¹⁶⁹ Although the NERA report was seven years old at the time relevant to this Decision, the OFT has no reason to believe that its findings are not still valid. In particular, it is consistent with a more recent, contemporaneous report by Transport Research Laboratory (TRL) which states: '...In Great Britain, a person in a car owning household is likely to make considerably fewer trips by...bus (66% less)...per week than a person in a non-car owning household. See: *The demand for public transport: a practical guide*, TRL, 2004, page 24.

¹⁷⁰ See the NERA report, page 5.

- (i) access to a car at the time of travel,
- (ii) the cost of cars and taxis relative to public transport, and
- (iii) the income of passengers.

4.86 However, these factors may vary at a local level. The following analysis therefore considers whether, in relation to such factors, there are any particular circumstances in Cardiff that would contradict previous findings that cars and taxis should be excluded from the relevant market definition.

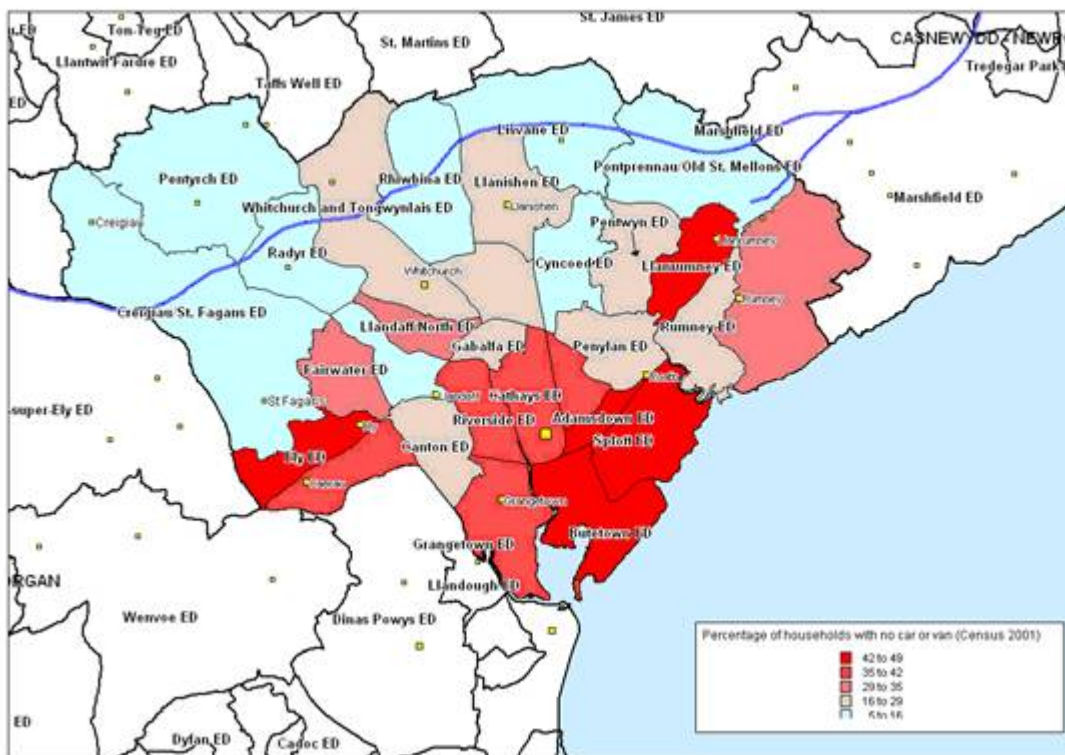
- (i) Access to a car at the time of travel

4.87 The 2001 census found that 29.7 per cent of households in Cardiff did not have a car.¹⁷¹ Figure 6 shows the proportion of households with no car or van by unitary electoral divisions of Cardiff.¹⁷² This shows that in those areas covering the relevant flows in this case, for example Ely and Llanrumney, the percentage of households with no car or van was particularly high, between 42 and 49 per cent. In Rumney and Fairwater the percentage of households with no car or van was also high, between 29 and 35 per cent.

¹⁷¹ *Census 2001*, National Statistics, 29 April 2001.

¹⁷² *Ibid.*

Figure 6: Proportion of households with no car or van by unitary electoral divisions of Cardiff



Source: Census 2001, National Statistics

- 4.88 Among bus passengers, the number without access to a car was higher. Research carried out for Cardiff Bus¹⁷³ indicated that more than half of its passengers did not have a car in their household. Over three quarters did not have their own car, and 59 per cent did not hold a driving licence. Over 70 per cent said that they did not have a car available for the journey.¹⁷⁴
- 4.89 Other research for Cardiff Bus found that only 37 per cent of its passengers ever used a private car or van, with 84 per cent using the

¹⁷³ *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003, page 9.

¹⁷⁴ OFT calculation from data in *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003, page 21.

bus as their most common form of transport.¹⁷⁵ 80 per cent said that the bus was the only method of transport available to them.¹⁷⁶ By contrast, among people who did not use buses as their main form of transport, 76 per cent most often used a private car or van.¹⁷⁷

4.90 The research also indicated that as the reported frequency of travel increased the less likely it was that there was a car available in the household that could have been used for the journey. Among those passengers using Cardiff Bus services daily, just over 60 per cent did not have a car in their household, two thirds did not hold a driving licence, and over 80 per cent did not have their own car.¹⁷⁸ This suggests that the passengers using buses most frequently are also those least likely to have access to a car as an alternative.

4.91 Bus passengers who do not own or have access to a car are highly unlikely to purchase a car in response to a five to 10 per cent increase in fares above the competitive levels, due to the wide disparity between the costs of bus fares and the cost of purchasing and running a car.

4.92 For bus passengers who do own or have access to a car, switching from buses to cars is potentially feasible, although the available evidence suggests that the extent of such switching would be limited given the findings described in the preceding paragraphs and below.

(ii) The cost of cars and taxis relative to public transport

4.93 In the case of taxis, the OFT notes that these can offer additional convenience to buses, for example, there is no requirement to travel to, or to wait at, a bus stop (although taxi users may need to request and wait for a taxi to arrive). However, the relatively high cost of taxi fares compared to bus fares limits the extent to which taxis are a demand

¹⁷⁵ *Cardiff Bus customer profiling (current and potential customers)*, Market Research UK, November 2004, page 4.

¹⁷⁶ *Ibid*, page 9.

¹⁷⁷ *Ibid*, page 19.

¹⁷⁸ *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003, page 9.

side substitute for buses. Even shorter taxi journeys are likely to be significantly more expensive than the comparable bus fare.¹⁷⁹

4.94 In the case of cars, even for those bus passengers who have access to a car, the cost of using the car for their journey may act to limit its attractiveness as an alternative to bus transport.¹⁸⁰ Other costs incurred in using cars as an alternative to bus services include parking costs.¹⁸¹

4.95 First told the OFT¹⁸² that, at £5 per day, it considered that car parking charges in Cardiff were relatively high, which encouraged a market for public transport. By contrast, however, Shamrock Travel stated¹⁸³ that car parking in Cardiff was cheap compared to other cities. Arriva told

¹⁷⁹ For example, in November 2008, the OFT collected quotes from taxi companies in Cardiff for a journey from Camelot Way, Thornhill to Cardiff Central Bus Station. These quotes varied between £10.00 and £13.00, which when deflated, would have been £8.80 to £11.50 in April 2004. Source: quotes collected from four taxi companies on 5 November 2008 by the OFT. OFT calculation of deflated figures uses RPI (fares & other travel costs: other travel costs, yearly figures from January 1987 = 100), from National Statistics, available at: <http://www.statistics.gov.uk/statbase/TSDSeries1.asp>.

¹⁸⁰ For example, in April 2006, a single adult ticket for the journey from Camelot Way, Thornhill to Cardiff Central Bus Station on the number 27 bus cost £1.80, while the estimated cost of the same journey by car was £2.69, excluding the costs of parking and time lost to congestion. Bus fare source: *Cardiff Bus guide to bus tickets and fares for Cardiff, Penarth, Barry and the Vale from 16 April 2006*. Car cost source: OFT calculation based on figures taken from www.theAA.com and AA Motoring Costs for petrol cars, 2006. The cost of the car journey assumes that the car's purchase price when new was £10,000 or less, and that it travels less than 5,000 miles per year. The AA estimated that in these circumstances, the cost of running a car was 54 pence per mile, including running costs such as fuel and depreciation and a portion of fixed costs such as insurance. The AA calculates the journey as 4.98 miles.

¹⁸¹ For example, in September 2005, pay and display car parks operated by Cardiff Council in the city centre charged £2.10 for a two hour stay and £4.10 or more for a stay of up to a day. At the same time, NCP car parks in Cardiff typically charged £3.00 for a two-hour stay, and between £8.50 and £20.00 for a stay of one day/24 hours. For comparison, Cardiff Bus offered a daily travelcard, called 'day to go', costing £3.00 that permitted one day of unlimited travel across its network. Bus fare source: *Cardiff Bus guide to bus tickets and fares for Cardiff, Penarth, Barry and the Vale from 16 April 2006*. Car parks source: Environmental Scrutiny Committee, Strategic Parking Guidance, Cardiff Council, 21 February 2006, containing 'Integrated Parking Strategy'. See paragraph 2.2.5 onwards, and Table 2.1. At: http://www.cardiff.gov.uk/objview.asp?object_id=4140.

¹⁸² Agreed note of meeting on 3 August 2006.

¹⁸³ Agreed note of meeting on 3 August 2006.

the OFT¹⁸⁴ that Cardiff Council was reducing the number of car parking spaces in Cardiff.

4.96 Cardiff Council's website states¹⁸⁵ that it aims to reduce car usage in Cardiff. Its 2006 parking strategy notes¹⁸⁶ that: '...there is overwhelming evidence and user feedback, that demand for parking exceeds supply in Cardiff'. Therefore, part of Cardiff Council's strategy¹⁸⁷ is that: 'Long term city centre parking by commuters will be discouraged and replaced by short term parking for shoppers and visitors'. The Council plans¹⁸⁸ to remove free parking where possible, and to '...set parking charges in line with the cost of public transport'. Parking charges were cited by 13 per cent of potential Cardiff Bus customers as a reason that would be likely to prompt them to start using buses.¹⁸⁹

4.97 A further cost of using a car relative to buses is additional time spent waiting in congested traffic. A number of roads in Cardiff have bus priority measures, such as bus lanes. For example, 120 junctions in Cardiff incorporate bus priority technology, which gives buses priority in moving through the junction over other types of traffic.¹⁹⁰ This suggests that the effects of congestion will be felt more by car users than bus passengers. The effects of traffic congestion and the possibility of congestion charges were cited by around 10 per cent of potential

¹⁸⁴ Agreed note of meeting on 3 August 2006.

¹⁸⁵ See: www.cardiff.gov.uk.

¹⁸⁶ Environmental Scrutiny Committee Strategic Parking Guidance, Cardiff Council, 21 February 2006, containing 'Integrated Parking Strategy'. See paragraph 2.2.2. Available at: http://www.cardiff.gov.uk/objview.asp?object_id=4140.

¹⁸⁷ Ibid, see page 2.

¹⁸⁸ Ibid, see page 2.

¹⁸⁹ *Cardiff Bus customer profiling (current and potential customers)*, Market Research UK, November 2004, page 29.

¹⁹⁰ See: *Bus priority: the way ahead*, DfT (October 2006). At: <http://www.dft.gov.uk/pgr/regional/buses/bpf/busprioritythewayahead12/busprioritythewayaheadpdfversion>.

Cardiff Bus passengers as factors that would prompt them to start using the bus.¹⁹¹

4.98 A 2002 report¹⁹² into Cardiff residents' views of transport in Cardiff, commissioned by the Council, found that almost half of residents felt that congestion in the city was excessive, with a further 38 per cent stating that congestion was excessive but only at peak times.

4.99 A local news report from July 2005¹⁹³ referred to the growing problem of traffic and pollution in Wales and stated that traffic volumes in Wales had reached a level that they had not been expected to reach for another decade. The article further stated that commuter traffic grows three per cent a year, 50 per cent above the British average. In addition, Cardiff Bus noted¹⁹⁴ that it was incurring additional costs [...] [C] because of '...the growing traffic congestion in the city – every year we are having to use more buses in the peak periods merely to maintain current frequency levels and reliability'.

(iii) The income of passengers

4.100 Access to cars, and usage of cars and taxis, may also be further limited by the amount of disposable income available for spending on transport. This may be a more significant issue in Cardiff than in other areas of the UK due to the socio-economic characteristics of Cardiff's population. For example, Figure 7 shows relatively high levels of unemployment across Cardiff, which would be likely to increase dependency on public transport in Cardiff.

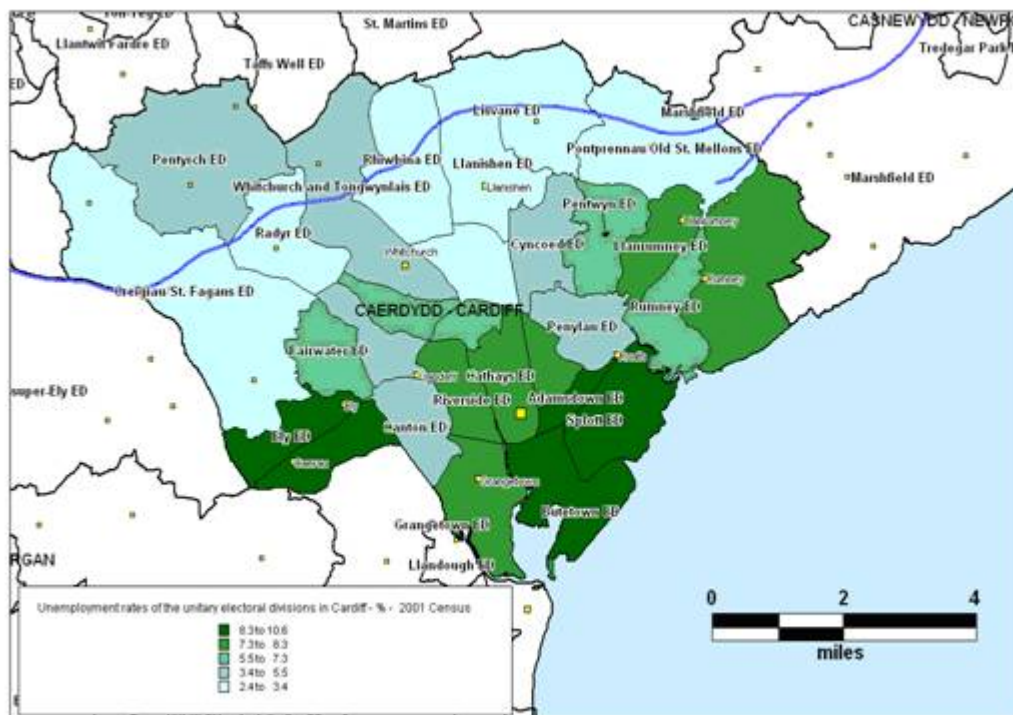
¹⁹¹ *Cardiff Bus customer profiling (current and potential customers)*, Market Research UK, November 2004, page 29.

¹⁹² *Traffic and Transportation*, Cardiff Research Centre, January 2002.

¹⁹³ BBC news website 12 July 2005 – '*Cardiff Congestion charge looming*'.

¹⁹⁴ Cardiff Bus Board Working Paper No. 434, 27 February 2006.

Figure 7: Unemployment rates in the unitary electoral divisions of Cardiff



Source: Census 2001, National Statistics

Conclusion on cars and taxis

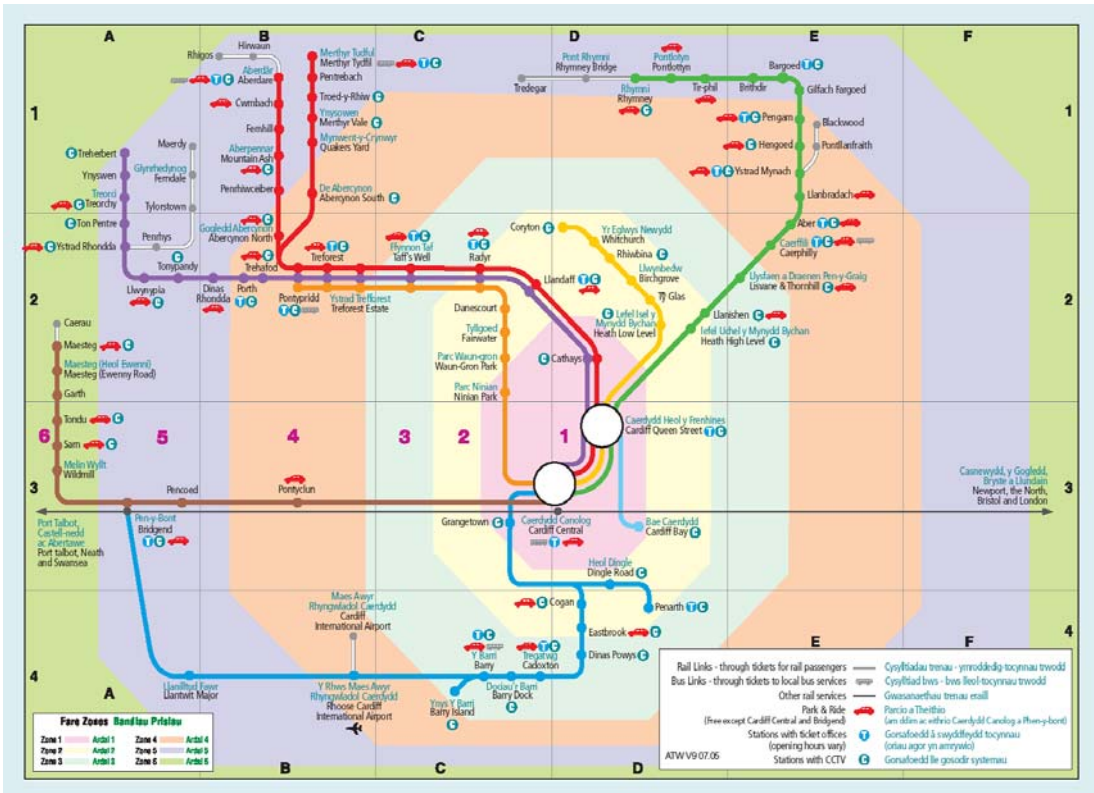
4.101 A high proportion of bus users in Cardiff lack access to a car for their journey, and depend on the local bus service. The relatively high cost of car and taxi journeys compared to the cost of bus travel means that a five to 10 per cent increase in the cost of bus travel above competitive levels would not be likely to prompt sufficient switching to cars and taxis for them to be included in the relevant market on the demand side. These factors are compounded by high levels of unemployment in the relevant areas of Cardiff, which may further restrict the affordability of cars and taxis relative to public transport.

4.102 Overall, the OFT concludes that the evidence in this case indicates that cars and taxis do not provide a sufficient competitive constraint on buses to be included in the relevant market. This is consistent with previous CC reports.

(f) Urban train services

4.103 Cardiff has an urban rail network made up of services on the Valley Lines network, operated by Arriva Trains Wales (Arriva Wales), part of the Arriva Group.¹⁹⁵ Figure 8 shows the stations on this network.

Figure 8: Arriva Wales route map



Source: <http://www.arrivatrainswales.co.uk/>

4.104 As stated above, the CC in the past has considered rail and bus substitutability on a flow-by-flow basis. In its merger report on *First Group/Scotrail*¹⁹⁶ it identified a number of factors that passengers would

¹⁹⁵ Arriva Wales is part of the Arriva Group, operating the rail franchise in Wales and employing more than 2,000 people. Arriva Group is one of the leading transport services organisations in Europe, operating a fleet of over 12,000 vehicles, employing more than 30,000 people, and providing more than one billion passenger journeys each year.

¹⁹⁶ *A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited*; Competition Commission June 2004, paragraph 4.19, page 14.

take into account when contemplating a journey on public transport, including whether a direct service was available or whether passengers had to change to another bus or train in order to travel to their final destination. Waiting times, which depend not only on the frequency of services but also on reliability, were also important, as were overall journey times and travelling conditions.

- 4.105 In that case, the CC concluded that: '...taking into account the specific characteristics particular to Glasgow with its extensive suburban rail network and those of Edinburgh and the Lothians, the CC therefore believes it is valid to regard train and local buses as at least potentially substitutable on some routes; and that control of bus and rail on a flow on which bus services and train overlap would enhance the position of a hypothetical monopolist on that flow. In the CC's view, point-to-point public transport journeys,¹⁹⁷ including bus and rail services which serve them where they overlap, can therefore be regarded as relevant markets'.¹⁹⁸
- 4.106 The NERA report noted that rail is not a particularly close substitute for bus services because rail networks tend to be far less dense than the local bus network.¹⁹⁹
- 4.107 In this case, the extent to which passengers regard urban train services as an alternative to bus services is likely to be limited by the extent of the overlap of the local rail network with the flows, the cost of travel and the frequency of services.
- 4.108 The main commuter train service in Cardiff operates on a north/south axis, as shown in Figure 8. Where bus services operate alongside the train route into and out of Cardiff there could be some competition for passengers. However, there appears to be no corresponding significant

¹⁹⁷ The CC defines a flow in *First/ScotRail* (Ibid) as follows: 'In order to travel from his or her origin to destination, a passenger will use a bus or train from one stop or station to another: the journey between those two points i.e. the two stops or stations is a flow'. Therefore point-to-point public transport journeys can be read as public transport journeys along individual flows.

¹⁹⁸ Ibid, paragraph 4.28, page 16.

¹⁹⁹ Page 5 (footnote 10) of the NERA report.

overlap of bus and rail services on the east/west axis. Chapter 5 notes only one flow where there is a limited overlap with one rail service (see paragraph 5.55 onwards).

- 4.109 Even where an overlap exists, the extent of the competitive constraint may be limited. For example, depending on the amount of road congestion at peak times and relative costs and availability, passengers may use a combination of bus and urban rail services. If this is the case they could be complements as well as substitutes.
- 4.110 Capacity constraints may also limit demand side switching at peak times. Arriva told the OFT²⁰⁰ that: '...if there was a shift in passengers from buses [to trains], the trains would not be able to accommodate the extra numbers'.²⁰¹
- 4.111 A survey of Cardiff Bus passengers found that, of 188 respondents who had recently decreased their usage of Cardiff Bus services, only six said that it was because they preferred trains.²⁰² Of those users who had recently started using Cardiff Bus services, 14.6 per cent had previously used the train, with almost half having previously used a car.²⁰³
- 4.112 Taking into account all of the above considerations, the OFT concludes that on balance urban rail services are demand side substitutes and form part of the relevant market definition, to the extent that they serve the same flows.

(g) Interurban train services

- 4.113 Interurban rail services are defined here as medium to long distance services that connect separate towns and cities. Cardiff is served by inter-city trains operated by First Great Western and Cross Country, but these only stop at the main stations (Cardiff Central and Cardiff Queen Street) within the Cardiff area.

²⁰⁰ Agreed note of meeting on 3 August 2006.

²⁰¹ Agreed note of meeting on 3 August 2006.

²⁰² *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003, page 17.

²⁰³ *Ibid*, page 11.

4.114 On the demand side, therefore, it is unlikely that consumers would switch to using interurban rail services if faced with a small but significant non-transitory increase in the price of bus fares, as they do not serve the same destinations. Therefore, the evidence indicates that interurban train services should not be included in the relevant market.

ii. **Cardiff Bus' comments on the OFT's product market definition**

4.115 In its written representations on the SO,²⁰⁴ Cardiff Bus stated that the OFT's approach considered each alternative form of transport in isolation, whereas if it had considered all forms of transport in aggregate then sufficient passengers would switch to some combination of alternative transport options to make any price increase unprofitable. In addition, it argued that the OFT had not considered the constraint imposed by passengers choosing not to travel in response to a price rise.

4.116 The OFT rejects these arguments. Whether it is profitable for a hypothetical monopolist to increase prices by five to 10 per cent depends on how many customers stop purchasing the product in question. One way of measuring this is by estimating the price elasticity of demand. In this regard, the OFT notes that price elasticity estimates for bus markets generally indicate inelastic demand (see paragraphs 4.75 to 4.79). Inelastic demand for buses would suggest that too few passengers would stop travelling by bus to render the price increase unprofitable. The elasticity estimate captures not only those passengers that switch to all other forms of transport, but also those that decide not to travel at all.²⁰⁵ The OFT has no evidence to suggest that local conditions are such that it should reach different conclusions in relation to the price elasticity of demand for buses in Cardiff.

²⁰⁴ Cardiff Bus' response to the OFT's SO, dated 7 August 2007, paragraphs 4.1 to 4.2.

²⁰⁵ In this respect, the OFT notes that on many of Cardiff Bus' routes, as well as on a network basis, there is no public transport alternative (see Chapter 5). Many bus users could not realistically walk, cycle or drive the distances they would otherwise travel by bus and some might choose not to travel in response to a bus fare increase.

4.117 Cardiff Bus also argued²⁰⁶ that it is '...inappropriate to analyse the substitutability of car driving, walking and cycling for no-frills bus services by reference to generalisations about Cardiff as a whole'. This suggests that substitutability of different modes of transport for no-frills bus services should be considered separately for each flow.

4.118 The OFT also rejects this argument. As noted at paragraph 4.43, the relevant routes (and hence also the relevant flows) lie close together on two main corridors out of the city: east and west. The physical proximity of these routes suggests that the conditions for demand side substitution are likely to be similar across many of the flows.

iii. Conclusion on product market definition

4.119 Based on the above analysis, the OFT concludes that the relevant product market definition includes:

- no-frills and normal bus services,
- tendered bus services,
- urban and interurban bus services where the flows overlap, and
- urban train services to the extent that they overlap with the relevant flows.

4.120 The following are excluded from the relevant product market definition:

- cycling and walking,
- cars and taxis, and
- interurban rail services.

²⁰⁶ Cardiff Bus' response to the OFT's SO, dated 7 August 2007, paragraph 6.3.

E The relevant geographical market

4.121 This Section takes its starting point, following on from Sections C and D, as the commercial and tendered bus services together with urban train services on the relevant routes, and network services in the Cardiff County area.

4.122 As discussed in Section B, when defining the geographic dimension of the relevant markets it is relevant to consider the possibilities for supply side substitution. Supply side substitution considers to what extent, and how quickly, undertakings would start supplying services in response to a hypothetical monopolist attempting to raise the price above the competitive level. For example, if operators of bus services nearby were able to switch services or expand quickly onto the flows in question, in response to a SSNIP, this might suggest that these should be taken into account in the market definition.

4.123 As noted at paragraph 4.8, however, the OFT's guidance states that: 'The OFT will not factor supply side substitution into the market definition unless it is reasonably likely to take place, and already has an impact by constraining the supplier of the product or group of products in question...If there is any doubt about whether or not to account for supply side substitution when defining the market and calculating market shares, the market will be defined on the basis of demand side substitutability, and the supply side constraint in question will be considered when analysing potential entry'.²⁰⁷

i. The potential for supply side substitution

4.124 The OFT considers that the possibilities for supply side substitution in this case are limited, for the reasons given in this Section and in Chapter 6.

²⁰⁷ See *Market Definition* (OFT403), paragraph 2.10.

4.125 In previous relevant cases,²⁰⁸ the CC has found there may be obstacles to supply side substitution, which have typically included:²⁰⁹

- network effects,
- natural barriers such as the lack of demand on certain routes, and
- strategic barriers resulting from aggressive responses to entry, including predation.

4.126 The OFT considers that its assessment of the extent of the potential for supply side substitutability should be based on the specific circumstances in each case. In this case, the obstacles mentioned in paragraph 4.125 are considerable as a result of the extent of Cardiff Bus' presence in the Cardiff urban area. Given Cardiff Bus' frequency and network incumbency (discussed in detail in Chapter 6), the OFT has concluded that these obstacles are barriers to entry that preclude supply side substitutability on a flow and individual route basis.

4.127 Furthermore, the extent of supply side substitutability will be limited where other bus operators are unlikely to redeploy their buses from existing routes because, for example, these routes are profitable commercial routes or are tendered.²¹⁰ In this respect, the OFT notes from Table 8 in Chapter 5 that Cardiff Bus was the only significant provider of urban commercial bus services in the County. As Table 8 shows, all of the actual competitors in this case predominantly operated either tendered or interurban services:

- For interurban services, their urban sections were likely typically to be limited to picking up (or dropping off) passengers travelling from

²⁰⁸ See for example *Stagecoach and Scottish Citylink: A report on the completed joint venture between Stagecoach Bus Holdings Ltd and Braddell Plc in relation to megabus.com, Motorvator and Scottish Citylink*, 23 October 2006, paragraphs 4.6, 4.13, and 4.40.

²⁰⁹ See generally, *Stagecoach and Scottish Citylink*, CC Report, 23 October 2006, Findings, paragraphs 6.76 to 6.82. Specifically on predation/retaliation, see: *Arriva plc and Sovereign Bus & Coach Company Ltd*, CC Report, January 2005, Findings, Appendix H, at paragraph 97. On network effects, see: *FirstGroup plc and the Scottish Passenger Rail franchise*, CC Report, June 2004, paragraph 5.69.

²¹⁰ See the OFT's *Guidelines on market definition*, OFT403, December 2004, paragraph 3.16.

one town to another, and would therefore represent only a small part of the entire route they served. Supply side substitution would require the operators of these services either to change the urban leg ends (which could be disruptive, confusing and reduce the value of the service to passengers),²¹¹ or to withdraw the interurban service entirely.²¹²

- In respect of tendered services, because these represent a stable and guaranteed source of revenue, operators would be unlikely to supply side substitute them to the more risky commercial services in response to a small increase in price on a route.²¹³ Furthermore, given their contractual status, the operators may in any case be unable promptly to switch them.

4.128 The OFT therefore believes that the potential for supply side substitution would be very limited. As a result of the limited possibilities for supply side substitution, the OFT believes in this case that supply side constraints are most appropriately considered when analysing potential entry, rather than market definition. Consequently Sections D, E and F in Chapter 6 provide a detailed assessment of supply side constraints.

²¹¹ See for example Decision ME/3404/07, *Completed acquisition by Go North East of Stanley Taxis*, 18 March 2008, paragraph 32: 'Further, the OFT considers that existing competitors already operating in the area where Stanley Taxis was active are capable of entering the relevant flows. Two of the parties' main competitors indicated that they keep changes to routes to a minimum...'

²¹² Supply side substitution is typically described in terms of the ability of operators easily to switch buses between routes **within** existing networks that they already operate. See, for example, paragraph 8 of *Review of methodologies in transport inquiries*, (Competition Commission, May 2007): 'There are also supply-side reasons that the appropriate geographic market may be wider than individual flows or routes. For example, as the CC noted in *FirstGroup/ScotRail*, bus operators organize themselves around bus depots and fleets and the wider networks they operate. Within these networks, existing operators can easily switch buses between routes'. In this case, other bus operators running interurban services (some of which were part-tendered), were not operating under conditions similar to those typical of a dense urban network like the one operated by Cardiff Bus.

²¹³ See for example Decision ME/3533/08 *Anticipated acquisition by FirstGroup plc of Truronian Limited*, 28 March 2008, paragraph 7: '...supply-side substitution between tendered and commercial services may not be symmetric, as tendered operators may find it more difficult to start to operate commercial services than the other way around. These two types of service have very different pricing mechanisms. An operator of a tendered service begins operations with effectively a guaranteed revenue stream, which makes investments and other business decisions less risky'.

4.129 However, as a cross-check, the OFT has also considered the implications for the definition of the relevant markets of taking into account supply side substitution. The OFT's analysis examines operators having the theoretical potential promptly to switch services in competition with Cardiff Bus, in line with the principles of the SSNIP test. Depot location is a key element of this assessment. **Annexe 2** details the OFT's approach and analysis, and discusses Cardiff Bus' approach in its representations on the SSO.

F Conclusion on the relevant markets

4.130 In this case, the OFT has considered the scope for demand and supply side substitution in defining the relevant markets. In geographic terms the OFT has considered the relevant markets both on a flow and route level and on a network basis (to capture the effect of network tickets). For the reasons set out in this Chapter the OFT concludes that the relevant markets are:

The provision of no-frills and normal bus services as part of the Cardiff Bus network together with urban bus services, and also interurban bus services and urban rail services (to the extent that they serve the same flows) into and out of Cardiff city centre. The supply of these services is considered both on the relevant routes operated by the white services and on a network basis in the Cardiff County area.

4.131 As discussed in paragraphs 4.26 to 4.29, while in this Decision the starting point of market definition at a geographic level is the individual flow, these flows are aggregated to routes for the purposes of assessing the relevant market.

4.132 Finally, for the reasons set out In Section E of this Chapter, the OFT does not consider it appropriate to extend the geographic market on the basis of supply side substitution. However, as a cross-check, the OFT has also considered the implications for the definition of the relevant markets of taking into account supply side substitution, the results of which are reported in Chapter 5 and **Annexe 2**.

5 DOMINANCE: ACTUAL COMPETITION

A Introduction

5.1 As explained in Chapter 3, in assessing whether an undertaking has substantial market power, it is helpful to consider market shares and the extent to which the undertaking faces competitive constraints. The most important constraints are actual competition and potential competition. Other factors such as strong buyer power from the undertaking's customers can also be relevant.²¹⁴ Available evidence from all indicators will be considered in the round before coming to an assessment of market power.

5.2 This Chapter focuses on the competitive constraints from actual competitors and other factors, while Chapter 6 considers the competitive constraints from potential competition. As set out in this Chapter, Cardiff Bus faced little actual competition from other bus operators, whether in respect of specific routes or across its bus service network.

i. Assessment of market power

5.3 The European Court has defined a dominant market position as: '...a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers'.²¹⁵

5.4 The European Court has also held that: '...such a position does not preclude some competition...but enables the undertaking which profits by it, if not to determine, at least to have an appreciable influence on the conditions under which competition will develop, and in any case to

²¹⁴ See *Abuse of a dominant position* (OFT402), paragraph 4.14.

²¹⁵ Case 27/76 *United Brands v Commission* [1978] 1 CMLR 429 paragraph 65. Also Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, paragraph 38.

act largely in disregard of it so long as such conduct does not act to its detriment'.²¹⁶

- 5.5 The OFT considers that an undertaking will not be dominant unless it has substantial market power.²¹⁷ While an undertaking's market share is an important factor in assessing whether it has market power it does not, in itself, determine whether an undertaking holds a dominant position. There are no strict market share thresholds for defining dominance under the Chapter II prohibition. However, the ECJ has stated that in the absence of contrary evidence there is a rebuttable presumption that an undertaking will be dominant if it has a market share persistently above 50 per cent.²¹⁸ The OFT considers it unlikely that an undertaking will be individually dominant if its share of the relevant market is below 40 per cent.²¹⁹
- 5.6 Market power is not an absolute term but a matter of degree, and the degree of market power that an undertaking possesses will depend on the circumstances of each case.²²⁰ It can be described as the ability profitably to sustain prices above competitive levels or to restrict output, innovation, or quality below competitive levels.²²¹
- 5.7 It is not necessary for a finding of dominance that an undertaking has eliminated all opportunity for competition in the market.²²² For the Chapter II prohibition to apply therefore it is not a condition that competition has been eliminated.
- 5.8 The existence of a dominant position may derive from several factors which, taken separately, are not necessarily determinative. In assessing

²¹⁶ Case 85/76 *Hoffmann-La Roche v Commission* [1979] ECR 461, paragraph 39.

²¹⁷ See *Abuse of a Dominant Position* (OFT402), paragraph 4.11. Also *Assessment of Market Power* (OFT415), paragraph 2.12.

²¹⁸ Case C62/86 *AKZO Chemie BV v Commission* [1993] ECR I-3359, 5 CMLR 215.

²¹⁹ However, dominance could be established below 40 per cent if other relevant factors (such as the weak position of competitors in that market and high entry barriers) provided strong evidence of dominance. See *Assessment of Market Power* (OFT415), paragraph 2.12.

²²⁰ See *Assessment of Market Power* (OFT415), paragraph 2.10.

²²¹ *Ibid*, paragraph 1.4.

²²² See Case 27/76 *United Brands* and Case 322/81, *NV Nederlandse Banden-Industrie Michelin v Commission (Michelin I)* [1983] ECR 3461, paragraph 59. See also footnote 546.

whether an undertaking has substantial market power, the OFT considers whether and to what extent an undertaking will face constraints on its ability to behave independently in the relevant market.²²³ These constraints might be:

- **actual competitors** - according to their strength in the market. This may be indicated by market shares, amongst other factors,
- **potential competitors** - this may be shown by a lack of significant entry barriers and the existence of other undertakings which might easily enter the market, and
- **other constraints** - such as significant countervailing buyer power exercised by the undertaking's customers and regulatory constraints.

5.9 The OFT deals firstly with these 'other constraints' (buyer power and regulatory constraints) below, before focusing in the rest of this Chapter on the assessment of actual competition, on the basis of the market definition and framework for analysis described in Chapter 4. The OFT assesses potential competition in Chapter 6.

ii. **Assessment of other constraints**

(a) **Buyer power**

5.10 In this case, the buyer power of individual passengers will be limited. As previously noted in this Decision, passengers' ability to switch to other forms of transport is limited, and the assessment of dominance below indicates that other bus operators do not offer sufficient alternatives to Cardiff Bus' services. While the local authority may arguably have some buyer power in respect of tendered bus services (because bus operators may be relying on the income generated from tendered services to subsidise other commercial services they are operating on that route at different times), this is not likely to benefit passengers of commercial services, which make up the majority of bus services in Cardiff.

²²³ See *Assessment of Market Power* (OFT415), paragraph 2.10.

(b) Regulation

5.11 Regulation may also impose a constraint on an undertaking's conduct. Chapter 2 set out the regulatory framework for the bus industry in South Wales. As that Chapter notes, bus services in Cardiff are regulated by the Traffic Commissioner for West Midlands and Wales. New bus services have to be registered with the Traffic Commissioner. The Traffic Commissioner can also de-register bus services on routes. However, he can only do this in limited circumstances, such as where the bus operator has failed to operate the registered services or has become insolvent. The Traffic Commissioner also has no coordinating role in relation to the provision of bus services. The Traffic Commissioner does not, therefore, impose any relevant constraint on the conduct of Cardiff Bus for the purposes of this investigation.

5.12 The evidence indicates that buyer power and regulatory constraints are unlikely to be strong in this case. The 'other constraints' category is not, therefore, considered further.

iii. Assessment of actual competition

5.13 The rest of this Chapter focuses on the competitive constraints from **actual** competitors, while Chapter 6 considers the competitive constraints from **potential** competition.

5.14 The assessment of actual competition starts in Section B, with a description of the commercial and tendered bus services within Cardiff County, before continuing in Sections C and D with an analysis of dominance in terms of the competitive constraints from actual competitors.

5.15 Notwithstanding that many passengers buy single tickets, the OFT considers that Cardiff Bus relies on its network for its market power (see Chapter 6). For this reason, the OFT concludes that the most appropriate market definition to lead the OFT's assessment of market power is the network. However, the network is itself a combination of the routes and flows, and the assessment of market power cannot

therefore be complete without an assessment also of the market defined on that basis. Therefore, a flow-specific assessment is also a necessary check on the OFT's assessment at a network level. The OFT's analysis in Chapter 5 therefore starts at the local level by assessing the market defined on a flow-by-flow basis for each of the relevant routes (Section C), before assessing it on a network basis (Section D).

- 5.16 Finally, although the OFT considers that supply side substitution is unlikely both on a route level and on a network basis (for the reasons set out at Section E of Chapter 4), the OFT conducts such an analysis in Section E of this Chapter (with the details set out in **Annexe 2**).

B Commercial and tendered bus operators

- 5.17 Table 8 sets out the available information on the commercial and tendered bus services within Cardiff County as at November 2005.²²⁴

²²⁴ Table 8 is based on the detailed responses to question 7 in the OFT's section 26 notices to third parties dated 24 November 2005 (see Table 7) requesting information on services within the Cardiff County Boundary. Note that the analysis of market shares in Chapter 5 is based on commercial and tendered services operating at the relevant time, as listed in the *Cardiff Bus, Rail and Tourist Map & Guide*, September 2003. The Office has no evidence that there are material differences between the information on which the market shares are calculated and the information on which Table 8 and the discussion in Section B is based.

Table 8: Commercial and tendered services provided by bus operators within Cardiff County, November 2005

Operator	Bus services
First	<p>Two interurban services:</p> <ul style="list-style-type: none"> • X2 – Commercial and part-tendered. Every 30 minutes in the day, hourly in the evening. Hourly on Sundays. • 100 – Commercial. Every 30 minutes in the day. Every 2 hours on Sundays. <p>Three suburban tendered school services: 628, 640 and 656.²²⁵</p>
Rhondda Buses Limited t/a Stagecoach in South Wales	<p>Five interurban services:</p> <ul style="list-style-type: none"> • 122 – Part-tendered. Every 30 minutes in the day, limited evening service. Every two hours on Sundays. • 131 – Part-tendered. Hourly service during the day. No evening or Sunday service. • 132 – Part-tendered. Every 30 minutes in the day, hourly in the evening. Hourly on Sundays. • X8 – Commercial. Hourly in the day. No evening or Sunday service. • X38 – Commercial. Hourly in the day. No evening or Sunday service. <p>Two tendered suburban services:</p> <ul style="list-style-type: none"> • 124 – Hourly, no service evenings or Sundays. • 136 – Hourly, no service evenings or Sundays.
Valley Bus Co Ltd t/a Stagecoach in South Wales	<p>One interurban commercial service:</p> <ul style="list-style-type: none"> • X78 – One journey every morning.
Parfitts Motor Services Ltd t/a Stagecoach in South Wales	<p>Four interurban services:</p> <ul style="list-style-type: none"> • A and B – Commercial. Every 30 minutes combined in the day. No evening or Sunday service. • X – Commercial. Three journeys into Cardiff in the morning and one departure in the afternoon. • 26 – Part-tendered. One journey every three hours.
Red and White Services Ltd t/a Stagecoach in South Wales	<p>Four interurban services:</p> <ul style="list-style-type: none"> • X3 – Commercial. Hourly in the day. No evening or Sunday service. • X4 – Commercial. Every 15 minutes in the day, hourly in the evenings. No Sunday service. • X16 – Part-tendered. Hourly in the day. No evening or Sunday service. • 16 – Tendered. Two departures in the evening. No Sunday service.
Newport Transport Ltd	<p>Two interurban joint commercial services with Cardiff Bus:</p> <ul style="list-style-type: none"> • 30 – Every 20 minutes, and every hour on Sundays and evenings. • 30D – Part tendered on Asda diversion. Every two hours, Monday to Fridays only.²²⁶
Islwyn Borough Transport	<p>One interurban part-tendered service:</p> <ul style="list-style-type: none"> • 26 – 10 journeys per day.

²²⁵ Dedicated tendered school services do not form part of the product market definition (see footnote 149) and have therefore been excluded from the OFT's analysis in this case.

²²⁶ See Newport Transport Bus Times, services from 15 August 2005.

Operator	Bus services
Jones Motors Services ²²⁷	Four interurban commercial services: <ul style="list-style-type: none"> • X49 – Hourly. • X45 – Every 30 minutes. • X6 – Every 30 minutes. • 19 – Every 30 minutes.
Wales and Marches	Eight tendered suburban services. ²²⁸ <ul style="list-style-type: none"> • 4 – Every 90 minutes (weekends only). • 22 – Every 90 minutes (weekends only). • 26b – Hourly. • 55 – Every 90 minutes (weekends only). • 56 – Every 90 minutes (weekends only). • 86 – Every 90 minutes (weekends only). • 1 – Every 90 minutes (weekends only). • 138 – Every 90 minutes (weekends only).
RH & DT Edwards Limited t/a Venture Travel	Tendered school services only. ²²⁹
Bebb Travel plc ²³⁰	Three interurban services: <ul style="list-style-type: none"> • 32 – Part-tendered. Hourly Monday to Sunday. • 121 – Tendered. Four services a day Monday to Saturday. • 155 – Tendered. Three services a day Monday to Saturday. Five tendered suburban services: <ul style="list-style-type: none"> • 3 – Hourly Monday to Saturday. • 6 – Every 10 minutes Monday to Friday. Every 15 minutes at weekends. • 16 - Four services a day Monday to Saturday. • 22 - Three services a day Monday to Saturday. • 26A - Five services a day Monday to Friday.
EST Buses	One tendered interurban service: <ul style="list-style-type: none"> • 87 – Five services between the hours of 09:30 and 15:00.
Glyn Williams Travel	Two tendered interurban services: <ul style="list-style-type: none"> • 26 – One service every two hours (Sundays only). • X17 – One service every two hours (Sundays only).

Source: Responses to the OFT's section 26 notice dated 24 November 2005 (see Table 7).

²²⁷ Part of Shamrock Travel.

²²⁸ Wales and Marches' response of 18 January 2006 states that services 4, 22, 55, 56, 86, 1 and 138 ran mainly every 90 minutes.

²²⁹ Dedicated tendered school services do not form part of the product market definition (see footnote 149) and have therefore been excluded from the OFT's analysis.

²³⁰ Bebb Travel also identified Pontypridd local services in its response to the OFT's section 26 notice, dated 24 March 2006.

(a) **Stagecoach in South Wales**

5.18 **Stagecoach in South Wales (Stagecoach)** is a subsidiary of the Stagecoach Group, which operates in over 100 towns and cities in the UK and runs a fleet of around 7,000 buses and coaches. Stagecoach in South Wales operates a fleet of over 400 buses and employs 800 staff in a variety of roles.²³¹ At the time, it provided services in and around Cardiff through a number of operating companies:

- **Rhondda Buses Limited:** operated a depot in Rhondda Cynon Taf, situated to the north west of the city,
- **Valley Bus Company Limited:** operated a depot in Methyr Tydfil, situated to the north west of the city,
- **Parfitts Motor Services Limited:** operated one depot situated less than 10 miles north of Cardiff,
- **Red and White Services Limited:** operated four depots, all to the north and north east of the city, and
- **Aberdare Bus Company Limited:** operated one depot to the north east of Cardiff. According to its section 26 response dated 20 January 2006, it did not operate any services within Cardiff from this depot (and it therefore does not appear in Table 8).

(b) **First**

5.19 **First Group plc** is the largest operator of bus services in the UK, running more than one in five of all bus services in the country, and carrying 2.8 million passengers per day.²³² First, a subsidiary of First Group, carries around 21 million passengers a year on a network of routes in the south and west of Wales, operating a fleet of around 350 vehicles, and employing almost 1,000 staff.²³³

²³¹ See: <http://www.stagecoachbus.com>.

²³² See: <http://www.firstgroup.com/> .

²³³ See: <http://www.firstgroup.com/ukbus/wales/swwales/about/index.php>.

(c) **Bebb Travel plc**

5.20 **Bebb Travel plc (Bebb Travel)** was a small bus operator, which has subsequently been taken over by Veolia.²³⁴ It operated on a small scale, with a fleet of 41 buses running from a single depot to the north and west of Cardiff.²³⁵

(d) **Shamrock Travel**

5.21 **Shamrock Travel** was established in 1975, and has also subsequently been taken over by Veolia.²³⁶ It operated in and around Cardiff through a number of operating companies:

- **RH & DT Edwards Limited:** traded under the name Venture Travel, and only operated tendered school services into Cardiff,
- **Jones Motors:** focused on delivering interurban services to Cardiff, and
- **Wales and Marches:** operated only tendered suburban services.

(e) **Other bus service operators**

5.22 Other operators in the County included:

- **Glyn Williams Travel** was established in 1974.²³⁷ It operated a depot located to the north of the city, but did not operate any commercial services from this depot,
- **Newport Transport Limited** was a small bus company that owned one depot in Newport,
- **Islwyn Borough Transport** had a depot in Blackwood, located to the north and east of Cardiff, and

²³⁴ Veolia Transport is an international company specialising in land and sea transport. It provides public transport in a number of countries. In 2005 it operated over 30,000 road vehicles. See <http://www.veolia-transport.com/en/company/>. [...][C]

²³⁵ Letter responding to the OFT's section 26 notice dated 24 November 2005.

²³⁶ See: <http://www.shamrocktravel.co.uk/lang/company.php>.

²³⁷ See: <http://www.welsh-transport-heritage.co.uk/glynwilliams.htm>.

- **EST Transport** had a depot in Cowbridge, located to the west of Cardiff.

C Flow-by-flow analysis

- 5.23 As noted in the first bullet of paragraph 5.8, the strength of actual competition may be indicated by market shares, amongst other factors. In the bus industry, market shares calculated from revenues and passenger numbers would best reflect the reality of demand side competition in the market. Passenger and revenue shares are among the approaches that the CC has previously adopted to evaluating overlapping flows in merger inquiries.²³⁸
- 5.24 In the current case the necessary data are not available to calculate these shares. When the OFT asked Cardiff Bus to provide it with its best estimate of market shares, Cardiff Bus initially stated²³⁹ that it felt unable to provide estimates, because it had not conducted a detailed market analysis, and it was unable to provide market share estimates based on patronage levels. Cardiff Bus subsequently provided estimates based on peak vehicle requirements (see paragraphs 5.65 onwards), a method which does not take into account usage levels and which requires an assessment of an equivalent measure for urban rail services.
- 5.25 The OFT has adopted an alternative methodology based on the frequency of the services offered (see paragraphs 5.71 onwards for further details). This is consistent with previous CC inquiries, which have looked at a range of measures including frequencies.²⁴⁰ Market shares based on service frequencies also do not take into account the actual level of usage of these services, and as such are a proxy for more accurate passenger and revenue figures. There is no reason to believe

²³⁸ See for example *Acquisition by Arriva plc of Sovereign Bus and Coach Company Ltd*, Competition Commission, January 2005, Annexe F.

²³⁹ Response to question 13 attached to letter to the OFT dated 11 July 2005; and letter to the OFT, dated 14 September 2005.

²⁴⁰ See for example *Acquisition by Arriva plc of Sovereign Bus and Coach Company Ltd*, Competition Commission, January 2005, Annexe F.

that using this proxy distorts the OFT's findings on dominance in any significant way that would affect its conclusions.

i. Methodology for the flow-by-flow analysis

(a) Introduction

- 5.26 This Section provides a flow-by-flow assessment of the existing competitive constraints faced by Cardiff Bus on the five relevant routes (for a description of these routes, see paragraphs 4.42 to 4.44 and Figures 1 to 4). The flow-by-flow analysis undertaken for this case considers the share of supply of Cardiff Bus and the other bus operators present on the relevant flows at the time. The analysis is based on the frequency of the bus and urban rail services which overlapped with Cardiff Bus' white services on the relevant flows.
- 5.27 As noted in paragraph 4.23, on any urban bus route there will be a large number of potential flows. In its analysis of merger cases, the CC typically applies a filter to all the potential flows to focus the analysis on those flows which might experience a substantial lessening of competition (SLC)²⁴¹ as a result of the merger.²⁴² In this case, however, the relevant question is whether Cardiff Bus held a dominant position on the relevant flows. Therefore, it would not be appropriate to use the same filters employed by the CC in its merger investigations.
- 5.28 It is possible to assess dominance by focusing on the shortest flows on the route – in other words, the flows between adjacent bus stops. The other flows on the route will be an aggregation of different combinations of these shortest flows. Therefore, establishing that Cardiff Bus is dominant on each of these shortest flows will also establish that it will be dominant on any longer flow on the five routes, since the extent of

²⁴¹ See *Mergers – Substantive Assessment Guidance* (OFT516), especially Chapter 3, for an explanation of the concept of a substantial lessening of competition.

²⁴² See *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*, Competition Commission, 23 October 2006. See Annexe G3, Table 1 for examples of filters used in recent cases.

competition faced by Cardiff Bus on a longer flow would be no higher than on any of these smaller flows.²⁴³ The OFT therefore did not consider it necessary to carry out an assessment on the longer flows.

5.29 The parts of the routes outside the centre of the city were assessed on a flow-by-flow basis, as described above. The city centre was analysed separately and as a whole, rather than being broken down into its constituent flows. This reflects the greater potential for demand side switching due to the presence of a large number of stops close together, and the less detailed information available on the services offered within the city centre.

5.30 The following Sections summarise in turn the approach taken for the flow-by-flow and city centre analyses. The methodology is explained in more detail in **Annexe 1**.

(b) Routes and flows outside the city centre

5.31 Both the flow-by-flow and the city centre analyses assess the frequency of the relevant bus and rail services, as listed in the *Cardiff: Bus, Rail and Tourist Map & Guide* - September 2003 (the guide). The guide, produced by Cardiff Council, details the number of services and frequencies operated per hour on each service by each bus operator. The OFT has also used data on rail frequencies supplied by Cardiff Bus.²⁴⁴

5.32 The frequency of each service was based on the number of services offered in total between 08:00 and 17:30 on a typical weekday. These hours were used as bounds for the frequencies because the exact start and finish times for services varied by route and company. The guide did not specify the actual start and finish times for each service, so a set

²⁴³ In principle, this is only true when bus services travelling along a long flow did not miss out any stops along the way. As discussed in **Annexe 1**, in practice, this is what actually happened with only one exception on the routes in question. The analysis has not been adjusted to take account of this one exception, because any effects are unlikely to be material.

²⁴⁴ Email dated 8 February 2006, contained a copy of rail timetable for period September 2003 to May 2004 timetable, with a note that it was the same as that which applied in 2004/05.

time period was used to ensure that the calculation compared bus service operators in a period in which they would definitely be offering bus services. Because actual start and finish times varied even more at weekends, the analysis was confined to weekdays only. The OFT has no evidence that suggests that limiting the analysis in this way either alters or distorts the assessment of dominance.

5.33 Where the guide was unclear, for example where it listed 'peak only' as the frequency, further clarification was sought from the timetable produced by the operator in question. If this was unavailable, the service was excluded from the frequency estimate.²⁴⁵ Where the frequency varied across different parts of the route in question, the frequency was recorded as the maximum frequency. For example, if the timetable listed '20/40 minutes' as the frequency, this indicated that buses ran every 20 minutes up to a certain stopping point on the route and then only every 40 minutes from this stopping point onwards. For these cases the frequency was taken to be 20 minutes.

5.34 The OFT has included all 2 Travel timetabled services in the frequency calculation. This is a generous assumption that favours Cardiff Bus, because the evidence suggests that 2 Travel may not have run some of its timetabled services (see paragraph 2.41). As a result, the market share of 2 Travel's competitors on the route, including Cardiff Bus, may be understated in the analysis.

5.35 The flow-by-flow analysis consisted of four stages:

- The first stage looked at the timetables for the white services and 2 Travel services, to establish the number of services being provided by each bus operator on the outward and return legs of each route. 2 Travel services listed as operating only on non-school days were excluded.

²⁴⁵ Only two services were excluded from the analysis because timetable data were unavailable. These exclusions are unlikely to be material to the analysis because both were peak only services, one of which was operated by Cardiff Bus. See Annexe 1.

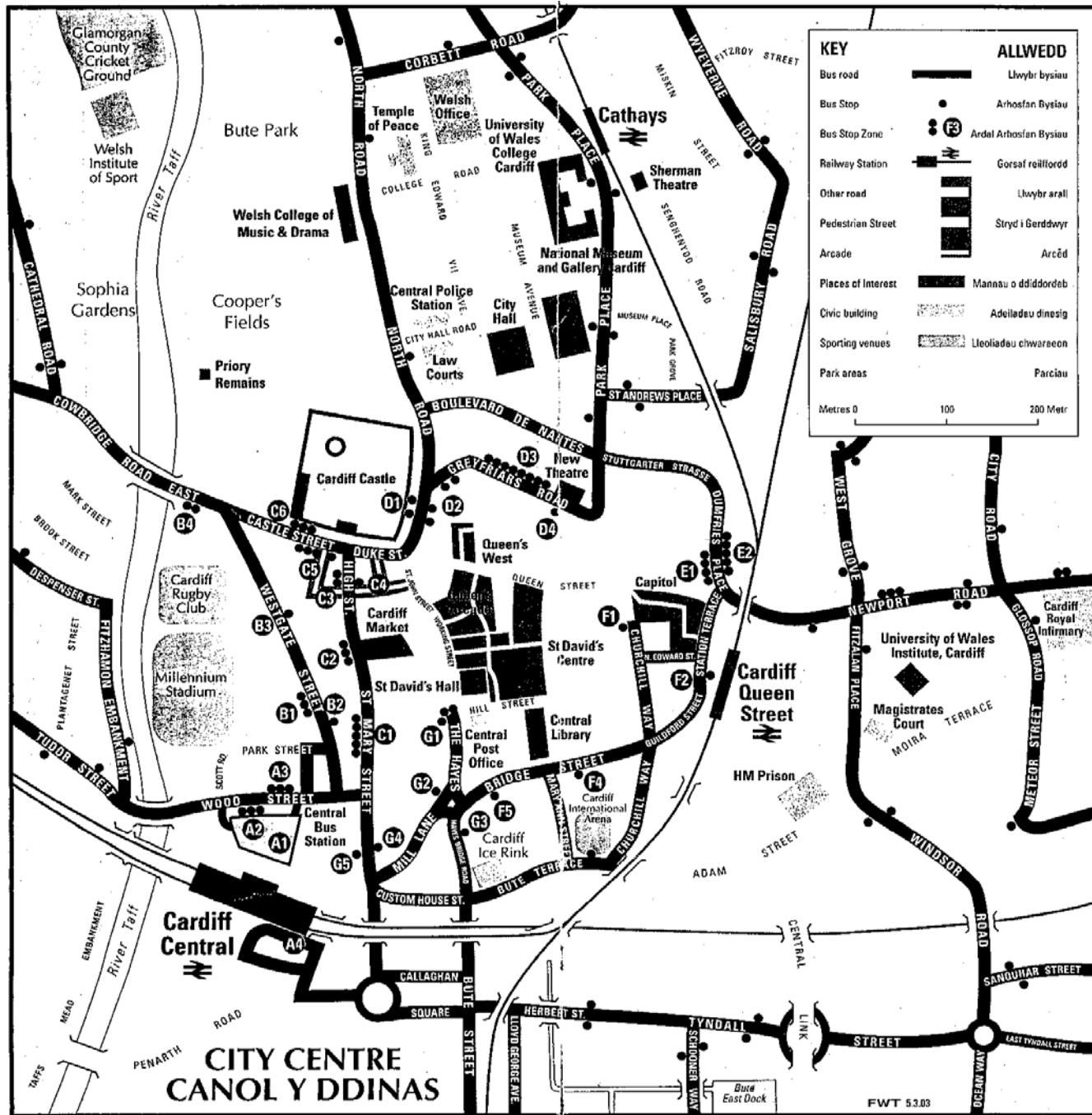
- The second stage established the frequency of Cardiff Bus' normal services and third party services operating on each of the smallest flows identified on the outward and return legs of each route.²⁴⁶
- The third stage combined the frequencies calculated in the previous two stages. From this, it was possible to determine the proportion of services operated by each company on each of the smallest flows for all routes.
- The fourth stage considered the frequency of services operating on the longest flow of each leg of the route, that is, from the route's starting point to its destination. This provides an assessment of the extent of actual competition faced by Cardiff Bus across the entire outward and return legs of these routes.

(c) City centre analysis

5.36 The city centre area (see Figure 9) contains many stops concentrated in a small area. Many of these stops, particularly around the central bus station, Westgate Street and St Mary Street, are close enough together for it to be reasonably easy for some passengers to walk between them. As a result, the OFT regards the flows within the city centre as being interchangeable, either with some or all of the other city centre flows. The analysis consequently treats all of the flows in the city centre together as a single flow rather than as a set of individual flows. The OFT has assumed for the purposes of this analysis that any service stopping at Cardiff Central Bus Station (or close by) will also operate on each of the flows within the city centre.

²⁴⁶ The flow-by-flow analysis is based on the timetables provided by Cardiff Bus and 2 Travel. As the timetables do not list all stops along the route the flow-by-flow analysis considers only those stops listed on the timetable.

Figure 9: Map of city centre



Source: Cardiff Bus, Rail and Tourist Map & Guide, September 2003.

5.37 This approach is consistent with the approach taken by the CC in the *Arriva/Sovereign* case. The CC in this case defined 'catchment areas' for bus overlaps because passengers may have a choice between bus stops that are within reasonable walking distance.²⁴⁷

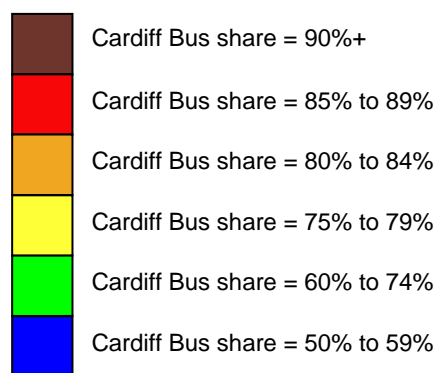
5.38 Consistent with the flow-by-flow analysis undertaken for the remainder of each route, the analysis of the city centre examined the frequency of bus services stopping at Cardiff Central Bus Station and considered the proportion of these frequencies provided by each operator.

ii. Results of the flow-by-flow analysis

(a) Analysis of market shares on routes and flows outside the city centre

5.39 The results of the flow-by-flow analyses of the white service routes, excluding the city centre, are illustrated in the flow diagrams below. The flow diagrams show the stops on the routes, labelled alphabetically for brevity. A list of the stops is in **Annexe 1**. Each pair of adjacent stops, for example AB and BC, is a short flow, and the colour of the flow illustrates the proportion of bus frequencies operated by Cardiff Bus, according to the key below (Figure 10). The tables list the percentage shares of each operator on each short flow.²⁴⁸

Figure 10: Key to proportion of frequencies for Cardiff Bus on each short flow



²⁴⁷ *Acquisition by Arriva plc of Sovereign Bus and Coach Company Ltd*, Competition Commission, January 2005, Annexe F.

²⁴⁸ Some of columns in the tables below may not add exactly to 100 due to rounding. Note that the flow diagrams are not to scale.

Figure 11: 144 service – outward flows (A to N)

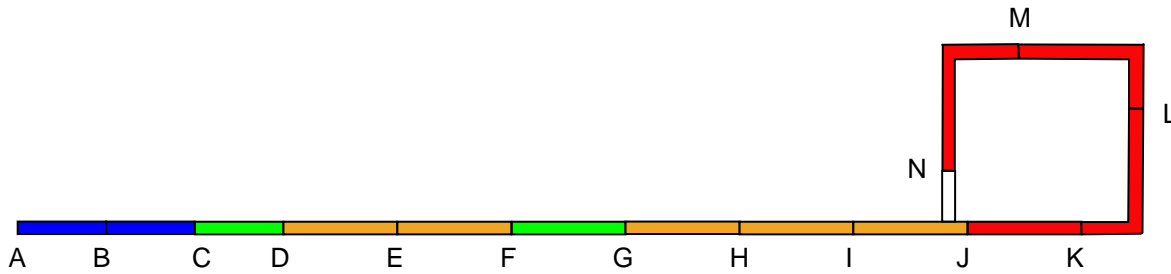


Table 9: 144 service outward flows – frequency shares by operator (per cent)

Flows	AB	BC	CD	DE	EF	FG	GH	HI	IJ	JK	KL	LM	MN
Cardiff Bus	58	58	71	82	82	72	82	82	82	81	88	88	88
2 Travel	8	8	9	18	18	28	18	18	18	19	12	12	12
Stagecoach South Wales	12	12	7	0	0	0	0	0	0	0	0	0	0
Newport Transport Limited	21	21	13	0	0	0	0	0	0	0	0	0	0

Figure 12: 144 service – return flows (N to Y)

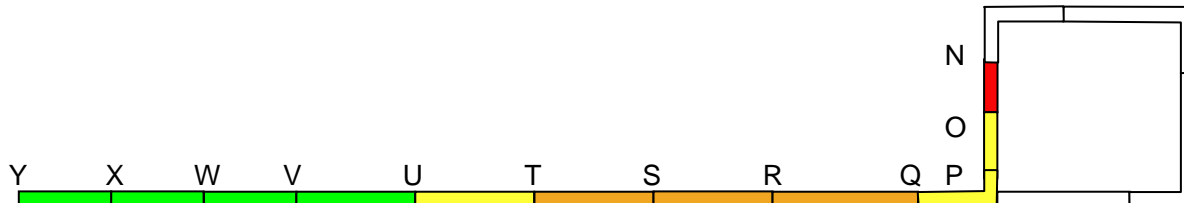


Table 10: 144 service return flows – frequency shares by operator (per cent)

Flows	NO	OP	PQ	QR	RS	ST	TU	UV	VW	WX	XY
Cardiff Bus	86	79	79	80	80	80	79	71	70	70	70
2 Travel	14	21	21	20	20	20	21	29	10	11	11
Stagecoach South Wales	0	0	0	0	0	0	0	0	7	7	7
Newport Transport Limited	0	0	0	0	0	0	0	0	12	13	13

- 5.40 On service 144 Cardiff Bus had a market share no lower than 58 per cent on any short flow. On average, it operated 78 per cent of the services by frequency on the outward leg flows (A to N), and 77 per cent for return leg flows (N to Y). On both the outward leg as a whole (flow AN) and return leg as a whole (flow NY) Cardiff Bus had a market share of 77 per cent.
- 5.41 2 Travel was the closest competitor to Cardiff Bus across the whole route, with a maximum market share of 29 per cent (on flow UV). Averaged across the short flows, 2 Travel operated 15 per cent of services on the outward leg flows, and 18 per cent on the return leg flows.
- 5.42 The other operators on this route, Newport Transport and Stagecoach, overlapped with service 144 only on the three short flows closest to the city centre on both the outward (AB, BC and CD) and return (VW, WX and XY) legs. Stagecoach operated two interurban services on these flows, both running on an hourly basis. Newport Transport also operated two interurban services - one every 20 minutes and one every two hours. Newport Transport operated these services jointly with Cardiff Bus but, to be conservative, the OFT has assumed in its calculation of market shares that only Newport Transport ran them. This means that Newport Transport's share on the relevant flows is overstated, to Cardiff Bus' advantage. Furthermore, as explained in paragraph 4.127, the OFT considers that interurban services do not provide the same level of competitive constraint as urban bus services, and with one exception these interurban services in particular operated at very low frequencies. Therefore, even where present on the route, these services were unlikely to be providing a significant constraint on Cardiff Bus.

Figure 13: 117 service – outward flows (A to J)

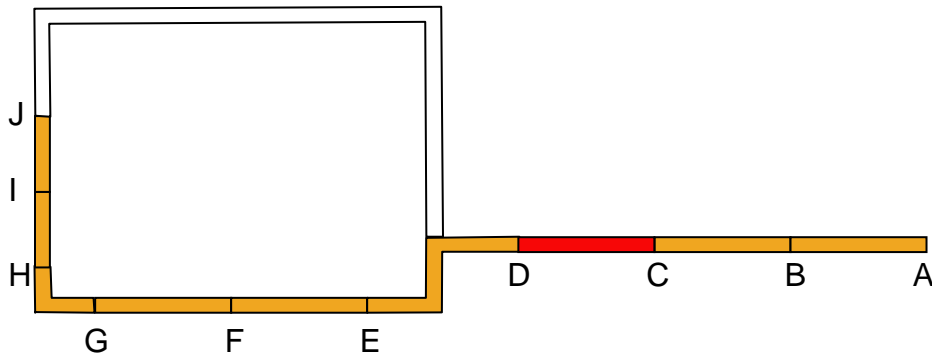


Table 11: 117 service outward flows - frequency shares by operator (per cent)

Flows	AB	BC	CD	DE	EF	FG	GH	HI	IJ
Cardiff Bus	82	83	88	81	84	84	81	84	84
2 Travel	10	10	5	16	16	16	16	16	16
First	7	6	6	0	0	0	0	0	0
Bebb Travel	1	1	1	3	0	0	3	0	0

Figure 14: 117 service – return flows (J to Q)

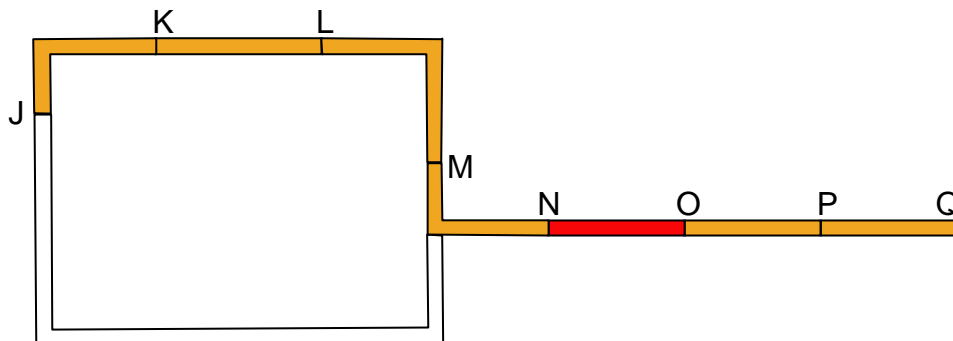


Table 12: 117 service return flows – frequency shares by operator (per cent)

Flows	JK	KL	LM	MN	NO	OP	PQ
Cardiff Bus	83	83	83	80	85	84	83
2 Travel	17	17	17	16	6	9	10
First	0	0	0	0	8	6	7
Bebb Travel	0	0	0	3	1	1	1

- 5.43 The data indicate that Cardiff Bus had a very high share of the services operating on service 117, with 80 per cent or more of the services by frequency on all of the short flows. On the outward leg as a whole (flow AJ) Cardiff Bus had a market share of 83 per cent and on the return leg (flow JQ) it also had a market share of 83 per cent.
- 5.44 Again, 2 Travel was the closest competitor to Cardiff Bus with a maximum market share of 17 per cent (on flows JK, KL and LM). Averaged across the flows, it had 14 per cent on the outward leg, and 13 per cent on the return leg.
- 5.45 First ran a part-tendered interurban service every 30 minutes overlapping with the 117 service on three flows of the outward (AB, BC and CD) and return (NO, OP and PQ) legs closest to the city centre. This interurban service is likely to have provided only a limited competitive constraint on Cardiff Bus as it operated at relatively low frequency, and overlapped on a limited number of flows. Bebb Travel also ran a tendered suburban service which overlapped with the 117 on five outward flows and four return flows, but was operated at a very low frequency (four services a day).

Figure 15: 150 service – outward flows (A to K)

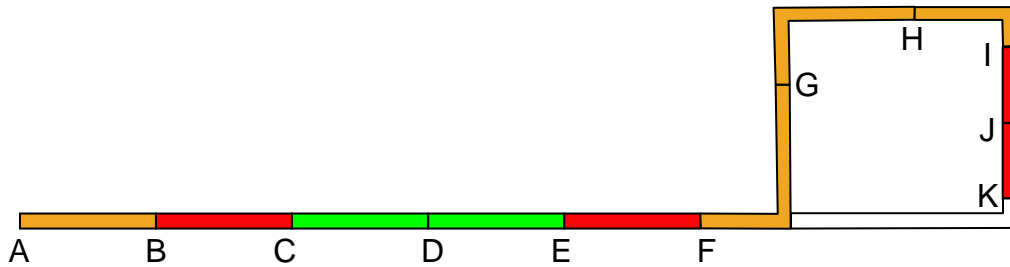


Table 13: 150 service outward flows – frequency shares by operator (per cent)

Flows	AB	BC	CD	DE	EF	FG	GH	HI	IJ	JK
Cardiff Bus	84	89	71	72	89	83	83	83	89	89
2 Travel	10	11	9	6	11	17	17	17	11	11
Stagecoach South Wales	0	0	7	5	0	0	0	0	0	0
Newport Transport Limited	0	0	13	17	0	0	0	0	0	0
Bebb Travel	6	0	0	0	0	0	0	0	0	0

Figure 16: 150 service – return flows (K to U)

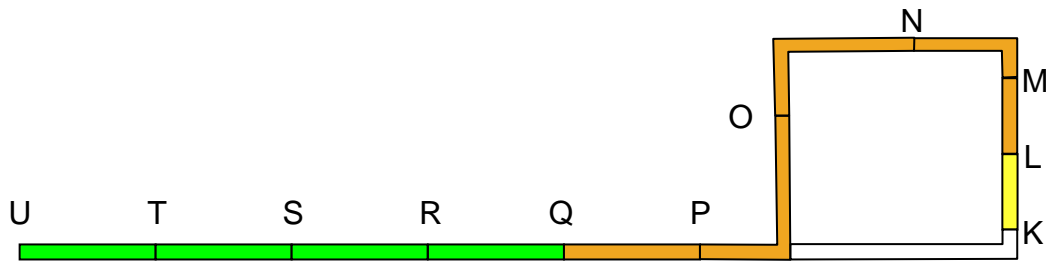


Table 14: 150 service return flows – frequency shares by operator (per cent)

Flows	KL	LM	MN	NO	OP	PQ	QR	RS	ST	TU
Cardiff Bus	79	80	80	80	80	80	66	70	70	70
2 Travel	21	20	20	20	20	20	14	10	11	11
Stagecoach South Wales	0	0	0	0	0	0	5	7	7	7
Newport Transport Limited	0	0	0	0	0	0	16	12	13	13
Bebb Travel	0	0	0	0	0	0	0	0	0	0

- 5.46 For both the outward and return legs of the 150 service, Cardiff Bus had a market share no lower than 66 per cent on each short flow. Averaged across all flows, Cardiff Bus operated 83 per cent of the services on the outward leg flows (A to K), and 75 per cent for return leg flows (K to U).
- 5.47 Again, 2 Travel competed most closely with Cardiff Bus across the whole route. It had a maximum market share of 21 per cent (on flow KL). Averaged across the flows, it had an average market share of 12 per cent on the outward leg, and 17 per cent on the return leg.
- 5.48 Stagecoach and Newport Transport each operated two interurban services on two flows of the outward leg (CD and DE), and on the four flows closest to the city centre on the return leg (QR, RS, ST and TU). Three of these services were hourly and one ran every 20 minutes. As above, the low frequency of these interurban services suggests that in practice these services were unlikely to provide much of a competitive constraint on Cardiff Bus. Furthermore, the services that Newport Transport ran which overlapped with the 150 service were operated jointly with Cardiff Bus. As noted in paragraph 5.42 the OFT has assumed in its calculation of market shares that only Newport Transport ran these joint services. This means that Newport Transport's share on the relevant flows is overstated, to Cardiff Bus' advantage.
- 5.49 Bebb Travel also ran a tendered service which overlapped with the 150 service. However, Bebb Travel's service was very infrequent (hourly) and only overlapped on one outward flow (AB), closest to the city centre.

Figure 17: 158 service – outward flows (A to J)

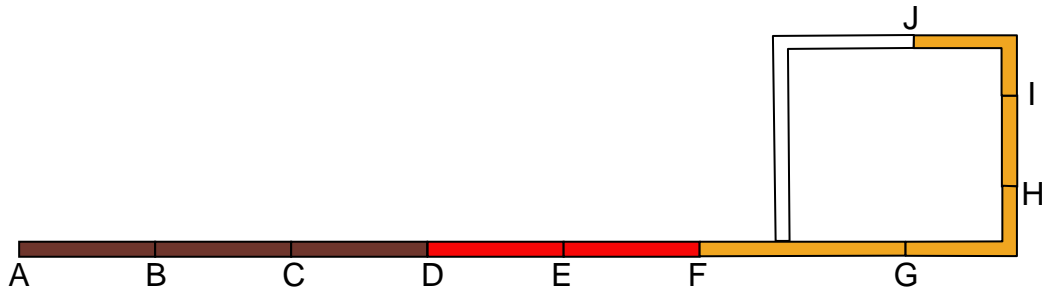


Table 15: 158 service outward flows – frequency shares by operator (per cent)

Flows	AB	BC	CD	DE	EF	FG	GH	HI	IJ
Cardiff Bus	93	92	91	87	87	80	80	80	80
2 Travel	7	8	9	13	13	20	20	20	20

Figure 18: 158 service – return flows (J to R)

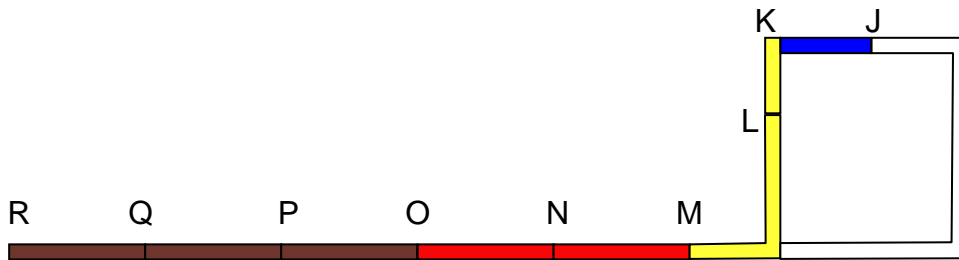


Table 16: 158 service return flows – frequency shares by operator (per cent)

Flows	JK	KK	LM	MN	NO	OP	PQ	QR
Cardiff Bus	50	78	78	86	86	90	91	91
2 Travel	50	22	22	14	14	10	9	9

- 5.50 For both the outward and return legs of the 158 service, Cardiff Bus had a share of frequencies of at least 50 per cent on each short flow. It had an average of 85 per cent on the outward leg, and 81 per cent on the return leg. On both the outward leg (flow A to J) and the return leg (flow J to R) as a whole, Cardiff Bus had a market share of 83 per cent.
- 5.51 2 Travel would have been the only competitor on the route, although in the event, it never operated its 258 service (see paragraph 2.35). If it had run its planned services, based on the available data 2 Travel would have had a maximum share of frequencies of 50 per cent on flow JK, but with a significantly lower share for all other flows. Because 2 Travel did not actually run the competing service, Cardiff Bus operated a monopoly on the route. However, for the purposes of this analysis the OFT has included the 2 Travel services as if they had been run. Making this assumption is favourable to Cardiff Bus.

Figure 19: 162 service – outward flows (A to I)



Table 17: 162 service outward flows – frequency shares by operator (per cent)

Flows	AB	BC	CD	DE	EF	FG	GH	HI
Cardiff Bus	82	83	80	73	68	56	71	67
2 Travel	10	10	20	27	32	44	29	33
First	7	6	0	0	0	0	0	0
Bebb Travel	1	1	0	0	0	0	0	0

Figure 20: 162 service – return flows (I to Q)



Table 18: 162 service return flows – frequency shares by operator (per cent)

Flows	IJ	JK	KL	LM	MN	NO	OP	PQ
Cardiff Bus	69	81	69	70	75	81	84	83
2 Travel	31	19	31	30	25	19	9	10
First	0	0	0	0	0	0	6	7
Bebb Travel	0	0	0	0	0	0	1	1

5.52 For both the outward and return legs of the 162 service, Cardiff Bus had a share of frequencies no lower than 56 per cent on each short flow. It had an average 73 per cent share on the outward flows, and 76 per cent on the return flows.

5.53 2 Travel provided the main competition on this route, and its highest market share (44 per cent) was on flow FG. It had an average market share of 25 per cent on the outward leg, and 22 per cent on the return leg.

5.54 First and Bebb Travel each ran one service that overlapped the 162 service on two outward and return flows closest to the city centre (AB, BC and QP, PO). However, these services are unlikely to have constrained Cardiff Bus. First's service was a relatively infrequent (every 30 minutes) interurban service, whilst Bebb Travel's service was a tendered suburban service that only ran four times a day.

5.55 Arriva Wales operated 14 urban rail services per day between the city centre and Waungron Park Station (stop D) and another 14 services (from stop N) back to the city centre. [...][C]²⁴⁹

5.56 Arriva believed²⁵⁰ that '...the train service provided a different service to the bus service. The corridors served were narrow, with few stations

²⁴⁹ [...][C]

²⁵⁰ Agreed note of meeting on 3 August 2006.

but quicker journey times. Local rail services within Cardiff are limited, with the network primarily serving the Valleys to the North and the Vale of Glamorgan to the South West. As a consequence there are large parts of Cardiff where there is no interaction between bus and train, but there is an overlap in some areas...Overall, Arriva considered that the main bus services tended to operate on an east west axis, while trains operated north south'. Arriva also noted²⁵¹ that train stations were often further away from the main concentrations of the local population and that Cardiff Bus' services also operated a '...high frequency service and so were potentially more attractive to passengers, particularly where there was a bus stop adjacent to the rail station...' As noted in paragraph 4.112, the OFT has included urban rail in terms of demand side substitution in the relevant market definition in this case, to the extent that they serve the same flows.

5.57 For the outward flow from the city centre to stop D, Cardiff Bus had 67 per cent of services. On the return flow from stop N back to the city centre, Cardiff Bus had 68 per cent of services on a frequency basis.²⁵²

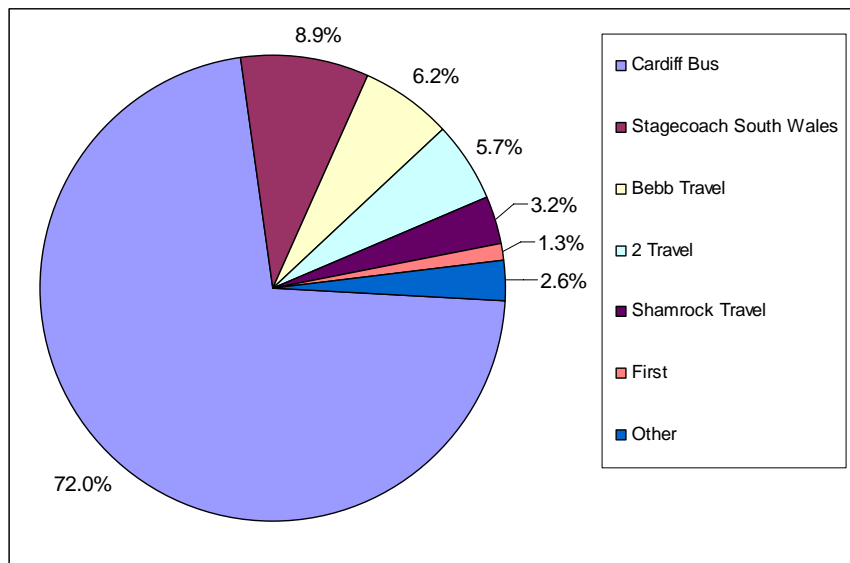
(b) Analysis of market shares in the city centre

5.58 Figure 21 shows the proportion of bus frequencies of all bus services stopping at Cardiff Central Bus Station by operator. The analysis shows that Cardiff Bus had the largest share of frequencies with 72 per cent of services. Of its competitors, Stagecoach had 9 per cent, Bebb Travel and 2 Travel both had six per cent each and Shamrock Travel had three per cent.

²⁵¹ Ibid.

²⁵² This analysis does not account for differences in the capacity of trains and buses. This is true throughout the frequency analysis.

Figure 21: Proportion of bus frequencies of all bus services stopping at Cardiff Central Bus Station



(c) Conclusion on the analysis of the routes outside the city centre and of the city centre

5.59 Looking at the flow-by-flow analysis on the routes excluding the city centre, Cardiff Bus had a market share on each of the small flows typically above 75 per cent. This gives rise to a rebuttable presumption that Cardiff Bus was dominant on these flows. What competition there was on the flows came mainly from 2 Travel, with other third parties operating much lower frequencies (which were also predominantly interurban and tendered services) where they overlapped at all.

5.60 The analysis of the city centre frequencies indicates that Cardiff Bus' share of services was 72 per cent. Stagecoach had the next largest market share, although the OFT considers that the extent of the competitive constraint it imposed on Cardiff Bus may have been more limited than the share figures suggest because most of these services were interurban services (see the discussion at paragraph 4.127 and at paragraphs 5.74 to 5.76).²⁵³ Bebb Travel and 2 Travel had similar shares

²⁵³ Note that interurban bus services are included in the relevant market definition, as noted at paragraph 4.61 onwards, to the extent that they serve the same flows as urban services.

of frequencies to each other, but their presence was so small that they were unlikely to constrain Cardiff Bus' operations to a meaningful degree.

5.61 Individually the third parties appear unlikely to have a sufficient presence to have provided any significant constraint on Cardiff Bus' operations. Even considering the other operators collectively, it appears likely that they did not operate a sufficient share of services to provide a strong constraint on the behaviour of Cardiff Bus. In addition, the fact that most of the third party services that operate on the routes are interurban services further reduced their ability to act as a significant constraint on Cardiff Bus' more frequently running urban services.

5.62 Overall, the analysis indicates that Cardiff Bus provided the overwhelming majority of the services (in terms of frequencies of services), on all routes considered. The OFT considers that other competitors did not provide a sufficient competitive constraint on these routes to counter the rebuttable presumption of dominance suggested by such high market shares.

D Network analysis

5.63 The flow-by-flow analysis above establishes that Cardiff Bus had a very high and the largest share on the relevant flows on the routes that the OFT examined. The following Section considers the extent of existing competition across Cardiff Bus' network.

i. Market shares in the network market

5.64 This Section sets out estimates of market shares in the network market. These estimates have been calculated using both Cardiff Bus' methodology, based on peak vehicle requirements (PVR),²⁵⁴ and the

However, as discussed in paragraphs 4.127 onwards, the actual competitive constraint exerted on Cardiff Bus by rivals' interurban services is likely to be weaker than competing urban services.

²⁵⁴ PVR is defined as the largest number of vehicles that are in service on a route at any one time.

OFT's alternative methodology based on service frequencies, calculated on a similar basis to the flow analysis in Section C.

(a) Cardiff Bus' estimates of market shares

5.65 Cardiff Bus provided²⁵⁵ the OFT with an analysis of market shares based on the peak vehicle requirements (PVR) of those operators that provided bus services into or within Cardiff.

5.66 In order to include urban rail services in the market share calculation, Cardiff Bus calculated the 'bus equivalent' of the relevant rail services.²⁵⁶ This measures, for each of the five rail lines serving Cardiff,²⁵⁷ the number of vehicles that would be required to provide a bus service to the same points and of the same frequency as the morning and evening peak rail service on that route. For example, the Cardiff Queen Street to Cardiff Bay rail service offers four services per hour. A bus would take 25 minutes to complete a journey from Cardiff Queen Street to Cardiff Bay in the traffic conditions prevailing at peak hours. Therefore, to provide four bus services per hour, it would be necessary to utilise two vehicles (because each vehicle could complete two journeys per hour).²⁵⁸

5.67 This analysis gives Cardiff Bus a 62 per cent share of supply when only bus services are included, and 58 per cent when urban rail services are included (see Table 19).

²⁵⁵ Letter dated 14 September 2005, in response to the OFT's letter of 9 August 2005.

²⁵⁶ Appendix D of letter dated 14 September 2005.

²⁵⁷ Cardiff Central to Lisvane/Thornhill, Cardiff Central to Taffs Well, Cardiff Central to Cogan, Cardiff Queen Street to Cardiff Bay, and Cardiff Central to Coryton.

²⁵⁸ OFT calculation, based on responses to Questions 1 to 10 and 21 of the OFT's section 26 notice dated 15 December 2005.

Table 19: Cardiff Bus' estimate of shares of services within Cardiff based on peak vehicle requirements (PVR), 2004

Bus Company	PVR for routes into, out of and within Cardiff	% share amongst bus services	% share amongst bus & rail services
Cardiff Bus	194	62	58
Stagecoach South Wales	56	18	17
Arriva Wales (rail)	19	-	6
Shamrock Group	17	5	5
2 Travel	15	5	4
Bebb Travel	14	4	4
First	11	3	3
Newport Transport Limited	3	1	1
Islwyn Borough Transport	2	1	1
EST Bus/Coaches	1	< 1	< 1

Source: Provided by Cardiff Bus in its letter to the OFT dated 14 September 2005. Percentage shares do not sum exactly to 100 due to rounding.

5.68 On the basis of these figures, in 2004 Cardiff Bus had a share of supply in excess of 50 per cent whether or not rail services are included in the relevant market definition.

5.69 Cardiff Bus also provided data for the number of 'o' licences held by each operator in the Cardiff area.²⁵⁹ These are listed in Table 20.

²⁵⁹ To register a local service the operator must hold a valid PSV operator's licence for each traffic area in which the operator has an operating centre. When an operator makes an application for a PSV operator's licence it will set out how many vehicles it will need to operate at any one time. If successful in its application the operator will then receive the required number of licence discs for display in its vehicles. These licence discs are generally known as 'o' licences.

Table 20: Cardiff Bus' estimate of operator shares by number of 'o' licences

Operator	Number of licences	Share (%)
Shamrock Group	593	29
First	412	20
Stagecoach	365	18
Cardiff Bus	275	13
2 Travel ²⁶⁰	210	10
Newport Transport Limited	90	4
Bebb Travel	60	3
Islwyn Borough Transport	47	2
Total	2052	100

Source: Cardiff Bus (data undated). Provided by Cardiff Bus in its letter to the OFT dated 14 September 2005. Percentage shares do not sum exactly to 100 due to rounding.

5.70 Table 20 shows that Cardiff Bus had 13 per cent of the operating licences held by operators running bus services into, out of, and within Cardiff. However, this includes licences that were not used for providing services into the relevant market. For example, First is listed as holding 412 'o' licences. However, First told the OFT in November 2005²⁶¹ that it operated only two interurban services (each of which ran no more frequently than every 30 minutes) and three suburban school tendered services. This suggests that only a small proportion of its 412 'o' licences would have been used to provide services in the relevant market in this case. In the OFT's view, therefore, this calculation significantly understates Cardiff Bus' competitive strength in the market and is not an appropriate measure of market share.

²⁶⁰ 2 Travel told the OFT that it had 110 'o' licences. Submission to the OFT prepared by 2 Travel, dated 3 November 2004. This appears to be confirmed by the Traffic Commissioner for Wales' Decision of 25 August 2004 in relation to 2 Travel Group plc, in which the Traffic Commissioner referred to 2 Travel having 110 operating licences (paragraph 21). If 2 Travel actually held 110 licences at the time then the correct market shares in terms of 'o' licences (assuming all the other figures in Table 20 are accurate) would be 14 per cent for Cardiff Bus and 6 per cent for 2 Travel.

²⁶¹ Letter responding to the OFT's section 26 notice, dated 24 November 2005.

(b) The OFT's estimates of market shares

5.71 The OFT prepared its own estimates based on the underlying data provided by Cardiff Bus, which it considers to be a more accurate proxy for revenue or the number of passengers carried by each operator than PVR (which focuses on the largest number of vehicles in service at any one time). The calculation considers the frequency on the outbound service only, that is, from Cardiff city centre to the route's final destination. See paragraph 5.26 onwards in the flow analysis Section for a description of the underlying assumptions regarding the hours of operation and peak services.

5.72 According to this methodology, Cardiff Bus supplied over 66 per cent of bus and rail services in the network market at the time of the operation of its white services, facing only fringe competitors (see Table 21).

Table 21: OFT's estimate of shares of services based on weekday daytime frequency of services

Bus/rail company	Number of weekday daytime services	Share (%)
Cardiff Bus	1,202	66.2
Stagecoach South Wales	149	8.2
Arriva Trains	147	8.1
2 Travel	95	5.2
Bebb Travel	94	5.2
(Jones Motors) Shamrock Travel	54	3.0
Cardiff Bus/Newport Transport Limited	28	1.5
First	22	1.2
Stagecoach South Wales/Islywn Borough Transport/Glyn Williams	9	0.5
Cardiff Bus/Bebb Travel	9	0.5
Newport Transport Limited	4	0.2
Sixty Six Coaches	3	0.2

Sources: OFT estimate based on frequencies in Cardiff: Bus, Rail and Tourist Map & Guide, September 2003 (listing services operating from this date onwards). Also Schedule of white services provided by Cardiff Bus to the OFT on 11 July 2005. Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004. Letter from 2 Travel's independent analyst, dated 1 November 2006.

5.73 Furthermore, as noted in Chapter 4 Section E and Section B of this Chapter, Cardiff Bus was the only significant commercial urban bus service operator in the County at the time. The other operators described in Chapter 4 and considered in the analysis of market shares

in this Chapter predominantly focused on providing interurban and/or tendered services.

- 5.74 It is also worth considering the nature of the actual competition from Stagecoach, the next closest competitor to Cardiff Bus in the network market, with an eight per cent market share. Much of the overlap between its services and those operated by Cardiff Bus was concentrated on two main routes leading to Cardiff Central Bus Station: North Road/Manor Way from the west, and Newport Road from the north east. Along these particular routes, Stagecoach offered a number of services throughout the day.
- 5.75 However, the extent of this competitive constraint was likely to be limited by the disparity in the frequency of the services. Cardiff Bus services 21 and 23, for example, covered similar routes and together were classed as 'frequent services', meaning that between them they offered a service approximately every 10 minutes.²⁶² By contrast, with the exception of the X4, none of the overlapping Stagecoach services operated more frequently than every half an hour, and many offered only a handful of journeys per day (see Table 8).
- 5.76 Overall, while there was some overlap between Stagecoach and Cardiff Bus services, this was limited to key corridors entering and exiting the centre of the city.
- 5.77 Given the predominantly interurban and tendered nature of the third party services and the infrequent services operated compared to those provided by Cardiff Bus, the OFT concludes that the competitive constraint facing Cardiff Bus on a network basis was limited.
- 5.78 In summary, both Cardiff Bus' estimate based on PVRs, and the OFT's estimate based on service frequencies, suggest a Cardiff Bus network market share well in excess of 50 per cent. These market share estimates are unlikely to provide a wholly accurate picture of Cardiff Bus' true position on the market, as neither methodology takes account

²⁶² *Cardiff: Bus, Rail and Tourist Map & Guide*, April 2006.

of usage levels. However, the OFT has no reason to believe that a calculation based on passenger numbers or revenues would demonstrate a lower Cardiff Bus share.

- 5.79 This Section has examined the market position in the relevant network market set out in Chapter 4. The OFT concludes that Cardiff Bus' share of this market was over 66 per cent, and that it faced only fragmented actual competition, with no other operator having notable market share.

E Analysis of the potential for supply side substitution

- 5.80 As explained in Section E of Chapter 4, the OFT believes that, in light of Cardiff Bus' frequency and network incumbency, supply side constraints are most appropriately considered when analysing potential entry. Consequently, Sections D, E and F in Chapter 6 provide a detailed assessment of supply side constraints. However, the OFT has also considered, in **Annexe 2**, the potential for supply side substitution on a network basis.
- 5.81 For the purposes of this analysis the OFT considered that an assessment of potential supply side substitution would include all bus operators with a depot within a 30-minute isochrone of Cardiff Central Bus Station. The methodology applied in the OFT's isochrone analysis and its results, along with Cardiff Bus' comments on the analysis, are discussed in detail in **Annexe 2**.
- 5.82 The results based on 30-minute isochrone analysis show Cardiff Bus' market share at 69 per cent (see Figure 22 and Table 22). When consideration is given to the sensitivity analyses (by calculating the results for 25-minute and 35-minute isochrones) and an average market share is calculated for these three isochrone analyses, Cardiff Bus' market share is still 69 per cent. The OFT concludes that Cardiff Bus had a much larger presence in the relevant market than the other bus companies with depots close enough to Cardiff to compete with it.

Figure 22: Depots of bus operators inside the 30-minute isochrone²⁶³

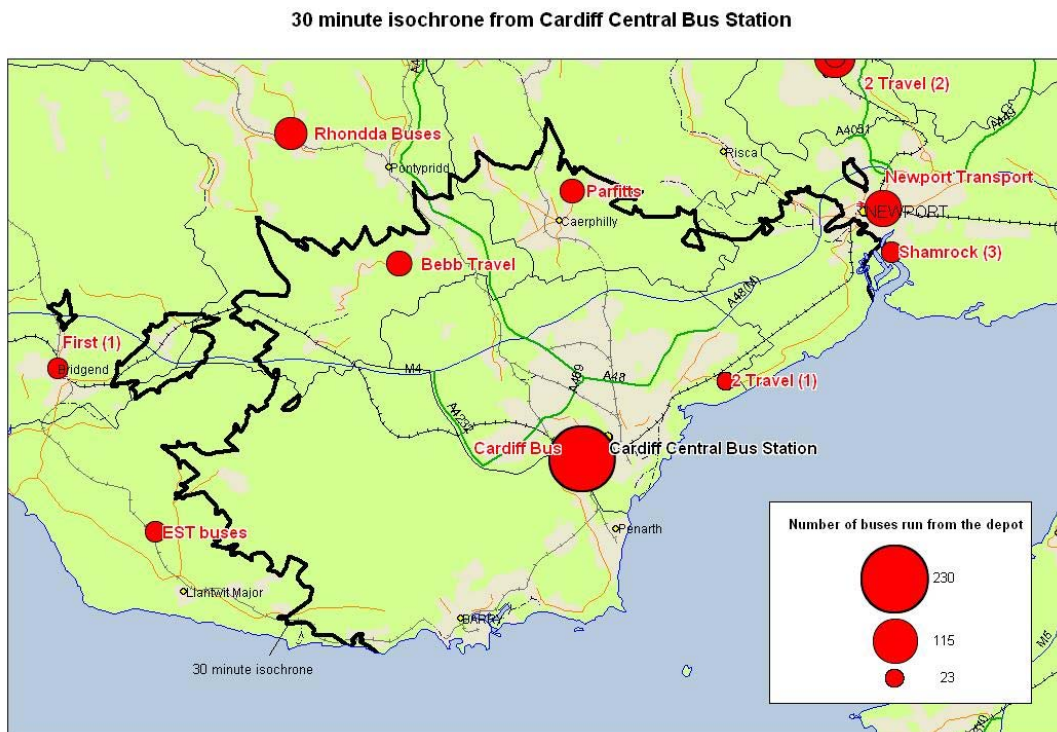


Table 22: Market shares based on the 30-minute isochrone

Bus operator	Depot location	Number of buses	Market share (%)
Cardiff Bus	Sloper Road	223	69
Bebb	Pontypridd	41	13
Parfitts	Bedwas	38	12
2 Travel	Wentloog Road	20	6

F Conclusion on actual competition

5.83 For the reason given in paragraph 5.15, while defining the relevant markets both on a route level and a network basis, the OFT considers that the network is the most relevant for the assessment of dominance. On this basis, **Cardiff Bus' share was over 66 per cent, and it faced only**

²⁶³ Isochrones were calculated using MapInfo.

fragmented actual competition, with no other operator having notable market share.

5.84 The OFT considers that an analysis of market shares on a flow-by-flow basis is also appropriate (see paragraph 5.15). On this basis:

- in terms of the city centre, Cardiff Bus accounted for **72** per cent of all bus services stopping at Cardiff Central Bus Station by frequency, and
- in terms of the flows outside the city centre, Cardiff Bus had a share on each of the small flows typically above **75** per cent.

5.85 Therefore, the OFT concludes that the evidence on market shares on the network, taken in the round with the flow-by-flow evidence, is sufficient to demonstrate that Cardiff Bus faced only limited actual competition at the time.

5.86 Finally, although the OFT considers that supply side substitutability is unlikely to constrain Cardiff Bus, for the reasons set out in Section E of Chapter 4 and in Chapter 6, as a cross-check, the OFT also considered the implications for the definition of the relevant markets of taking into account supply side substitution. On this basis, Cardiff Bus' market share was **69** per cent within a 30-minute isochrone.

6 POTENTIAL COMPETITION

A Introduction

6.1 The previous Chapter set out the evidence concerning the limited nature of the actual competitive constraints on Cardiff Bus' conduct. However, as noted in paragraph 5.8, in assessing whether an undertaking has substantial market power, the OFT also considers whether and to what extent an undertaking will face constraints from potential competitors on its ability to behave independently in the relevant market. In this context, potential competition refers to the scope for new entry, or for expansion by existing competitors.

6.2 This Chapter therefore considers the competitive constraint on Cardiff Bus' behaviour imposed by potential competition. The market definition in this case (see Chapter 4) suggests that potential competitive constraints could come from new or expanded rail or bus services. This Chapter therefore considers the presence of urban rail operators (Section B), before focusing on bus operators in Cardiff and the potential, given possible barriers to entry, for these operators to expand or to switch their services to further constrain the conduct of Cardiff Bus (Sections C, D, E and F). It considers the history of entry, expansion and exit in Cardiff, as well as what existing competitors have told the OFT about their plans for expansion and the factors that might act to reduce the likelihood of such future expansion (Section G). Finally, it considers the relevance of the ownership and governance of Cardiff Bus (Section H).

B Potential competition from rail services

6.3 As noted in footnote 195, Arriva Group is one of the leading transport service providers in Europe. Arriva Wales is part of the Arriva Group, operating the rail franchise in Wales.

6.4 It appears unlikely to the OFT that rail capacity could be significantly expanded to cover more routes because of the enormous expense of setting down new railway and providing more trains.

- 6.5 Furthermore, rail operators are subject to a licensing regime administered in the UK by the Office of Rail Regulation under the Railways Act 1993. The rail operator is also subject to The Rail Safety and Standards Board. While the OFT has not considered the costs of compliance with the requirements of the licensing regime, the costs of regulation from entry or expansion as a rail operator are likely to be considerably higher than that of a bus operator and would impose a significant cost on a new entrant contemplating the commencement of rail services in the Cardiff (or indeed any other) urban area.
- 6.6 Taking into account all of these considerations, the OFT concludes that the extent to which potential competition from trains would operate as a competitive constraint on Cardiff Bus will be very limited. This Chapter therefore focuses on the potential for new entry and expansion of existing bus services in Cardiff and the surrounding area, and considers factors that may operate as barriers to their entry and expansion.

C Potential competition from bus operators

i. Barriers to entry

- 6.7 The strength of potential competition depends on the extent of barriers to entry. Even an undertaking with a large market share may not have market power if there are low entry barriers.²⁶⁴ Entry barriers might allow an undertaking to exert its dominance and thus profitably earn and sustain supra-competitive profits in the long term, without being more efficient than its potential rivals. Entry barriers include not only those factors that prevent entry but also those that impede expansion.
- 6.8 This Chapter considers the following three potential barriers to entry in this case:
- Cardiff Bus' network (see Section D),
 - costs of entry (see Section E):

²⁶⁴ See *Assessment of Market Power* (OFT415), paragraph 5.4.

- scale and scope economies
- depot availability, and
- reputation for aggressive response to entry (see Section F).

6.9 The OFT considers that these are relevant and important barriers. They are relevant to the bus industry and have been identified in past CC inquiries.²⁶⁵

ii. Models of entry or expansion

6.10 The potential models of entry or expansion can be described in terms of three main service attributes:

- **quality of service**, in terms of frequency and bus quality:²⁶⁶
 - high frequency of service/quality of bus,
 - low frequency of service/quality of bus, and
- **timetable**:
 - peak,
 - off-peak,
 - peak and off-peak, and
- **scale of operation**:
 - a few previously unserved and/or minor routes,
 - a few core corridors, and
 - an extensive network.

²⁶⁵ See for example *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*. Competition Commission, 23 October 2006.

²⁶⁶ The OFT considers that the combination of service frequency and quality of buses does not appreciably alter the conclusions of this analysis. Indeed, available evidence is not sufficiently strong to establish whether the quality of service (primarily the physical attributes of the buses used), substantially affects how consumers differentiate between bus operators. See: TRL report, 2004, *The demand for public transport: a practical guide*, page 20, section 3.2.6.

6.11 The first of these criteria (quality of service) also identifies two general types of business model: respectively, full-service and no-frills. A full-service-operator (FSO) offers a high frequency and high quality service, while a no-frills operator offers a comparatively low frequency and quality service. In this respect, Cardiff Bus promoted itself, and was broadly perceived by third parties, as a full-service operator (FSO) running an extensive network during peak and off-peak hours.²⁶⁷

6.12 Different combinations of the three above criteria (quality of service, timetable and scale of operation) present a range of potential entry or expansion patterns. However:

- In terms of scale of operation, Cardiff Bus' extensive network coverage is unlikely to leave viable unserved routes available for competitors to implement a niche strategy which would enable them to avoid competing head-to-head with Cardiff Bus (see paragraphs 6.29 onwards for further discussion of this). Of course, even if such niche entry were possible, the fact that Cardiff Bus was not facing direct competition on its routes from the new entrant would mean that the extent to which that new entrant would constitute a competitive constraint on Cardiff Bus would be limited.
- For the same reason, in terms of timetable, the OFT considers that it would not be feasible to enter or expand into Cardiff as an FSO by running only off-peak services, because the market potential would be insufficient to justify the corresponding level and quality of service provided. Therefore an FSO would need to cover peak hours. To simplify its analysis, therefore, the OFT considers that it is reasonable to group together the remaining timing options into two: 'peak', and 'peak and off-peak'.
- Similarly, although a no-frills operator could enter on either a peak or a peak and off-peak basis, it is reasonable to assume that serving only off-peak hours along a few core routes would be its

²⁶⁷ See, for example: *Cardiff Bus – Achieving the Vision through Partnership 2005-2009*, page 7.

preferred niche entry strategy. This strategy would avoid head-to-head competition with the incumbent, by enabling the no-frills operator to segment the market. However, this niche entry or expansion pattern would not preclude the possibility that the no-frills operator might choose to enter on a peak times basis, or attempt to escalate its no-frills business model, both in terms of timetable and coverage, once it had established a viable foothold in the market.

6.13 Therefore, it is possible to map the remaining set of potential entry or expansion patterns using a two-dimensional matrix:

		Scale of operation	
		Few core corridors	Network and/or peak
Quality of service	FSO (peak and off-peak)	Cell 1	Cell 2 (Cardiff Bus' business model)
	No-frills	Cell 3 (2 Travel's business model)	Cell 4

6.14 In this case, the analysis that follows in this Chapter suggests that network effects were likely to be the main barriers to potential entry by FSOs on a small scale and focussing on a few core corridors (Cell 1) – see Section D. Moreover, were an FSO to enter or to expand on a large scale (Cell 2), the costs of entry could act as a further barrier – see Section E.

6.15 In terms of the no-frills models of entry²⁶⁸ and expansion, the analysis suggests that an aggressive response by Cardiff Bus was likely to be a significant strategic barrier to small scale entry (Cell 3) – see Section F. The deterrence of a small-scale no-frills entry or expansion model could

²⁶⁸ Entry could, for example, be based on an operator's established tendered services (as was 2 Travel's entry in this case), which would provide a guaranteed source of revenue.

prevent its escalation, both in terms of timetable and coverage (Cell 4).²⁶⁹ This issue is discussed further in Section D of Chapter 7.

- 6.16 The OFT considers that these entry barriers faced by potential competitors reinforced Cardiff Bus' strong market position relative to its actual competitors.
- 6.17 From a demand-side perspective, the two models (FSO and no-frills) can also be considered in terms of two profiles of consumption that align with them.²⁷⁰ On a specific flow, the two most important factors explaining demand for bus services are the price and the total trip time,²⁷¹ the latter being the sum of actual trip time and the time spent waiting for the bus (also known as 'schedule displacement').²⁷² This last component (the time spent waiting) inversely reflects the frequency of service, which is more important in local bus markets characterised by relatively short journeys, because the time people spend waiting represents a larger proportion of their total trip time.
- 6.18 Consequently, in local bus markets, frequent services are likely to be particularly valued by many consumers who are willing to pay to avoid having to wait too long for a bus. However, some consumers (most typically the 'time rich') may be more willing to trade off waiting for a bus in return for lower fares. Accordingly, it is also possible to identify two consumption profiles:

²⁶⁹ A no-frills operator might eventually adopt an FSO business model, although the radical differences in terms of operating conditions and marketing requirements would be a challenge. However, such a business development pattern would still face the barriers corresponding to Cell 1 and, eventually, Cell 2 in the matrix at paragraph 6.13.

²⁷⁰ This discussion focuses on potential competition from bus operators, and therefore those factors that may differentiate bus services, rather than the determinants of demand for bus services more generally compared to other transport modes.

²⁷¹ As noted earlier in this Chapter, available evidence is not sufficiently strong to establish whether the quality of service (primarily the physical attributes of the buses used), substantially affects how consumers differentiate between bus operators. See TRL report, 2004, *The demand for public transport: a practical guide*, page 20, section 3.2.6.

²⁷² Schedule displacement is solely assessed in terms of headway (the waiting time at the boarding point).

- more time-sensitive (less price-sensitive) consumers, who are likely to favour FSOs over no-frills operators, and
- more price-sensitive (less time-sensitive) consumers, who are likely to favour no-frills operators over FSOs.

D Cardiff Bus' network

6.19 As discussed in Chapter 4, the CC has previously stated that wider public transport network markets could be defined as a network (a collection of interconnected services) in relation to particular bus operators' services or a wider geographical area.²⁷³ In this case, for the reasons described below, the OFT considers that Cardiff Bus' network is a barrier to entry or expansion by FSO competitors because of:

- Cardiff Bus' network coverage and service frequency,
- the nature of the local multi-operator travelcard ticket (MTC) scheme, and
- Cardiff Bus' ability to respond to new entrants.

6.20 These factors in relation to potential FSO entry are discussed below.

i. Cardiff Bus' network coverage and service frequency

6.21 The extensive coverage of a network and the service frequency provided on flows can leave less room for a new entrant to set up a competing network successfully. This is particularly true for a potential competitor adopting a full-service business model, which primarily relies on demand from time-sensitive consumers (see paragraphs 6.17 to 6.18).

6.22 The NERA report²⁷⁴ argues that route entry at a lower service frequency than is offered by an incumbent, usually means that the entrant secures

²⁷³ *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* (published 23 October 2006).

²⁷⁴ In its written representations on the OFT's SSO (at paragraph 3.22), Cardiff Bus contested the OFT's reference to the 1997 NERA report on the grounds that it has been superseded by

a less than proportionate share of the market. This is because the incumbent is able to deploy ticket pricing strategies, such as discounted returns and network tickets, which tie in consumers by offering them savings provided they consume more.²⁷⁵

6.23 Likewise, the extensive coverage of a network can enable demand-side scope economies in consumption, because consumers value the combinations of schedules and routes.²⁷⁶ Again, incumbents can take advantage of this network effect by selling network tickets, which can only be used on their buses.²⁷⁷

6.24 In effect, by capitalising on service frequency and network coverage through the use of exclusive ticketing strategies, the incumbent can introduce contractual 'switching costs'.²⁷⁸ These switching costs can be both intertemporal (relating to the discount on repeated purchases over time of the same product, such as a weekly ticket for one route); or cross-product (relating to the discount on the one-off purchase of a

subsequent OFT and CC reports. However, the OFT refers to the NERA report here to inform the relevant theoretical arguments, rather than for factual analysis. Furthermore, the OFT notes that the CC has also made reference to the NERA report in its most recent inquiries – for example, see: *Stagecoach/Scottish Citylink*, Appendix K – Market Entry and Expansion, paragraph 14, available at http://www.competition-commission.org.uk/rep_pub/reports/2006/fulltext/516ak.pdf. See also: *Arriva/Sovereign*, Appendix H – Potential Competition, paragraph 92, available at http://www.competition-commission.org.uk/rep_pub/reports/2005/fulltext/496ah.pdf.

²⁷⁵ Page 21 of the NERA report.

²⁷⁶ In this respect, the OFT notes the findings in the *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003. This report found that out of 2,082 respondents, approximately one in four (24 per cent) claimed that they travelled on a variety of services in and around the city (page 19, question 8).

²⁷⁷ In this respect, the OFT notes the findings in the *Cardiff Bus Public Consultation*, Cardiff Research Centre, May 2003. This report found that of those respondents claiming that their usage of Cardiff Bus had recently increased, 17.2 per cent indicated that this was as a consequence of purchasing a bus pass (page 12). This increased demand is likely to have been a result of passengers using passes to take more journeys at no or little additional cost.

²⁷⁸ See paragraph 4.13 for an explanation of switching costs. The switching costs described here are endogenous in the sense that any incompatibility between the incumbent's ticket schemes (and thus any savings from special offers and discounts attached to them), which creates switching costs, is at the discretion of the incumbent and not forced upon them by external requirements.

bundle of products, such as a network ticket). This latter type of switching costs is sometimes called 'shopping costs'.^{279, 280}

- 6.25 The typical frequency pattern of consumption for network tickets (with shorter duration tickets, such as daily and weekly passes, representing a higher proportion of sales than longer duration tickets) may also allow incumbents to react rapidly to new entry by altering their fares quickly to make them more competitive.²⁸¹
- 6.26 In summary, one effect of a network is that it may make it difficult for entrants to win customers because users benefit from the network tickets offered by the incumbent. These demand-side network effects may also encourage incumbents to expand their network to try to pre-empt entry attempts.²⁸²
- 6.27 The ability of an incumbent to pre-empt, or to react quickly to new entry, by using ticketing strategies that take advantage of its network, is particularly effective towards entry by FSOs, given the latter's focus on consumers who are time-sensitive and prefer to buy tickets for a service that minimises waiting times.²⁸³ In other words, the presence of demand-side scale and scope effects would require FSOs to achieve a

²⁷⁹ See the OFT's Economic Discussion Paper on Switching Costs, April 2003, (OFT655), Part 1, paragraph 2.16. This report is referred to in this Decision as the 'OFT report on switching costs'.

²⁸⁰ In this respect, the NERA report argued that the effect of these bus tariffs is analogous to frequent flyer programmes in the airline industry (page 21). The OFT report on switching costs noted that frequent flyer programmes combined switching and shopping costs (paragraph 4.71), and might have lock-in effects which are likely to be greater the higher the airline share of flights in a particular region (paragraph 3.41).

²⁸¹ In *FirstGroup plc and the Scottish Passenger Rail franchise*, CC Report, June 2004, paragraph 5.59, the CC noted that FirstGroup responded to entry by Stagecoach, one of the major operators in Glasgow, by lowering the price of its weekly tickets.

²⁸² The OFT report on switching costs noted that in the airline industry carriers enjoyed a competitive advantage in markets in which they provided frequent services to a variety of destinations. In particular, this competitive advantage attributed a disproportionate share of the traffic relative to the corresponding frequency share. It is worth noting that these observations were made before some of the recent developments in the airline industry, such as the growth in Europe of low-cost carriers. See the OFT Report on switching costs, Appendix C, section 1.

²⁸³ The OFT report on switching costs suggested that the combination of switching and shopping costs may lead firms to produce a 'socially excessive' number of products, but insufficient variety, thus inducing competition between full-range firms offering very similar product ranges (Appendix A, paragraph 7.18).

large scale in order to match the incumbent's scale,²⁸⁴ but the existence of contractual switching costs may make this much more difficult.²⁸⁵

6.28 In this respect, the OFT notes that Cardiff Bus operates an extensive network of bus services in Cardiff that it refers to as an 'overground' service (see Figure 5). Cardiff Bus told the OFT that at the time it introduced the white services, it '...had been developing a network of core corridor frequent services, with an awareness of the additional patronage that could be achieved by moving from an irregular or infrequent service to a more regular "turn up and go" service. This lead [sic] to the development of an "overground" service which is now common across the industry'.²⁸⁶ Cardiff Bus has also stated that its objective is to: '...operate a comprehensive and integrated network of services from early to late, seven days a week'.²⁸⁷

6.29 Comments from third parties suggested that viable opportunities for entry into Cardiff were limited by the extent and coverage of Cardiff Bus' network:²⁸⁸

- [...] [C] stated²⁸⁹ that: 'On its main network CB [Cardiff Bus] runs a frequent service which would limit the opportunity for any new operator entering the market to find an appropriate time slot'.
- [...] [C] told the OFT in its response to a section 26²⁹⁰ notice that it was unlikely that it would choose to enter the market in the future,

²⁸⁴ The NERA report noted that in the absence of a large cost advantage over the incumbent, the only circumstance in which undifferentiated entry could be expected to be successful is via a large scale, multi-market entry, depriving the incumbent of its multi-market advantage (page 22).

²⁸⁵ The OFT report on switching costs argued that in the presence of switching and shopping costs, large scale entry is difficult because it requires entrants to steal business from the incumbent (Appendix A, paragraph 5.13).

²⁸⁶ Letter responding to the OFT's section 26 notice dated 17 August 2006.

²⁸⁷ Managing Director's Report, dated 31 January 2006.

²⁸⁸ Although these comments were made after the time of the operation of the white services, the OFT does not consider there to be any reason for doubting, in the circumstances of the present case, that the comments were equally relevant to the situation in the market at the time. In that regard, the OFT notes that the network position of Cardiff Bus has remained largely unchanged since that time.

²⁸⁹ [...] [C]

²⁹⁰ [...] [C]

because it appeared that the '...area is well serviced by Cardiff Bus and there is no obvious area where a new service could be justified'.

- [...] [C] stated that it: '...would need to invest more than the current value of our own operation in view of the need to recruit, obtain local premises, and local management. Since Cardiff already serve the entire city, then the initial revenue would not support the level of investment required....There are slow average speeds in the city and contrary to uninformed opinion there is high value in network coverage as opposed to simple routes'.²⁹¹
- [...] [C] noted²⁹² that it considered Cardiff Bus '...has a big influence as Cardiff bus (sic) has a large financial backing and also it has the confidence. They are also able to purchase brand new vehicles, which gives other operators little chance to compete. [...] [C] would not be able to compete against Cardiff Bus and with the announcement of the increase of their profits there is no way [...] [C] would be able to enter a tender competition with them'.
- In a section 26 response, [...] [C] commented²⁹³ that it had not considered expanding into either urban or network services in the Cardiff County area in the past five years.

6.30 Finally, as noted in paragraph 6.25, incumbents may be able to make use of the short duration of most network tickets to react quickly to entry. In this respect, evidence in a report by the TAS partnership to Cardiff Bus (the 'TAS report')²⁹⁴ suggests that the use of network tickets in Cardiff was not particularly developed at the time, despite about 45 per cent of Cardiff Bus' passengers being regular users of its services (five days a week or more). According to the TAS report, this was because of Cardiff Bus' unfavourable pricing strategy, which meant that its tickets were relatively expensive compared to other parts of

²⁹¹ [...] [C]

²⁹² [...] [C]

²⁹³ [...] [C]

²⁹⁴ *Cardiff Fares & Ticketing Strategy, A report to: Cardiff Bus, TAS (2006), paragraph 3.3.4.* This report is referred to in this Decision as the 'TAS report'.

England and Wales.²⁹⁵ Furthermore, the TAS report suggested that Cardiff Bus' sales of weekly tickets were hindered by the need for users to produce proof of identity and to register in advance for them, as well as because the tickets were not being sold on buses.²⁹⁶

- 6.31 These limitations to Cardiff Bus' sale of network tickets suggest that it was not being disciplined by the threat of potential entry at that time. However, given Cardiff Bus' frequency and network incumbency, potential competitors would be likely to be aware of its ability quickly to realign its ticketing strategy in the face of a real threat of entry or expansion into Cardiff.
- 6.32 In April 2006 Cardiff Bus implemented the recommendations in the TAS report to generate consumer loyalty, but also primarily to increase the proportion of pre-paid ticket revenue and therefore improve its financial profile.²⁹⁷ This intention was evidenced by a Cardiff Bus press release issued in that month,²⁹⁸ which stated that: 'The reduced price day ticket, covering an extended area, will be particularly attractive to those making longer journeys, multi journeys, or where a journey involves a change of bus'.
- 6.33 Since that time, Cardiff Bus has continued to increase prices for single tickets relative to those for network tickets. In March 2007, it announced that:²⁹⁹ 'The fares review recognises the importance of encouraging regular bus use, and the price of the highly successful on-

²⁹⁵ Ibid, paragraphs 2.2.5 to 2.2.6: 'In comparison to other urban areas day tickets and one-week ticket use in Cardiff is low. We believe this is because: *i*) City Rider prices are high in comparison to even the highest adult return fare, and *ii*) The requirement for a photocard and the limited number of sales outlets for period tickets suppresses demand. Experience in urban areas where operators offer a simple one-week ticket for purchase on the bus show...that this can increase use of prepaid tickets by up to 50% of all passengers. Cardiff currently achieves around 22%'. See also paragraphs 3.5.3 to 3.5.4, and 4.3.1.

²⁹⁶ Ibid, paragraph 3.5.3.

²⁹⁷ Ibid, paragraph 6.2.1.

²⁹⁸ See Cardiff Bus press release dated 4th April 2006, 'Fares Review - from Sunday 16th April 2006'.

²⁹⁹ See Cardiff Bus press release dated 19th March 2007, 'Fares Review - from Sunday 1st April 2007'.

bus Day/Week to Go tickets has been frozen. Monthly ticket prices have also been frozen or reduced'.

6.34 A press report dated 19 March 2008³⁰⁰ indicated a continuation of this policy. It quoted David Brown (Managing Director of Cardiff Bus) as saying: 'A key aim of our annual review was to keep our Day-To-Go ticket price at £3. This ticket has been phenomenally successful since its introduction, both because of its simplicity, and the value that it represents. We have also been able to hold the price of our three and four zone tickets. The need to increase other ticket prices is unavoidable, as our own cost base which is tied particularly to wages, fuel, insurance and energy costs continue to grow with or ahead of inflation'. The press report also noted:³⁰¹ 'The new charges will take effect from April 6 and mean the cost of an adult single ticket in the city will rise from £1 to £1.20 while a child's single ticket will rise from 70p to 80p. However, some prices have remained the same with the Day-To-Go ticket remaining at £3 and the price of tickets in zones three and four holding at their current charge'.

6.35 These fare changes are discussed further in Chapter 7. The OFT considers that they have had the effect of further increasing the value of Cardiff Bus' network as a barrier to entry.

6.36 The OFT concludes that Cardiff Bus' frequency and network incumbency was a barrier to entry against full-service bus operators.

ii. **The nature of the multi-operator travelcard ticket (MTC) scheme**

6.37 A multi-operator travelcard ticket (MTC) is a ticket that provides unlimited travel for a particular period of time on more than one operator's services. In its SO,³⁰² the OFT noted that Cardiff Bus

³⁰⁰ Source: South Wales Echo, 19 March 2008: 'Cardiff Bus ups prices to maintain services'. See: <http://icwales.icnetwork.co.uk/news/cardiff-news/2008/03/19/cardiff-bus-ups-prices-to-maintain-services-91466-20646496/>.

³⁰¹ Ibid.

³⁰² The OFT's SO, dated 15 May 2007, paragraph 4.95.

participates in an MTC scheme, which allows unlimited travel on Cardiff Bus' services as well as other operators' services. The 'Network Rider' is valid within the Cardiff County boundary. The ticket is accepted by Cardiff Bus, Stagecoach, Newport Transport Limited, Glyn Williams Travel, Bebb Travel, Shamrock Travel and Islwyn Borough Transport Limited.³⁰³ It is recognised for travel in an area stretching approximately 30 miles from the centre of Cardiff.

- 6.38 This scheme should reduce the ticketing advantage of the Cardiff Bus network. However, the OFT considers that the existence of the MTC system would not enable a potential competitor to overcome Cardiff Bus' frequency and network incumbency. The three reasons on which the OFT has based this consideration are discussed below.
- 6.39 Firstly, the MTC scheme appears to cater mainly for interurban-urban journeys, being either for regular interurban commuting or leisure travel, rather than for urban-only usage. Factors such as changes in economic activity and tourism, rather than bus operators' policies or the intensity of competition in Cardiff's local bus market, are more likely to drive demand for MTC tickets. Therefore, it is unlikely that the number of MTC tickets purchased would be affected by the entry of a new urban operator.³⁰⁴ Consequently, Cardiff Bus' frequency and network incumbency would continue to be an advantage to it.
- 6.40 Secondly, because of its urban-interurban scope, the MTC scheme's fares are priced well above equivalent urban network tickets that are only valid on Cardiff Bus' network. Other operators would be unlikely to try to bypass Cardiff Bus' frequency and network incumbency by joining the MTC scheme because, to compete for the urban-only travellers, the

³⁰³ [...] [C] cited difficulties in joining the local travel card scheme as a barrier to effective market entry (see letter responding to the OFT's section 26 notice [...] [C]). In this respect, the OFT notes that the Ticketing Schemes Block Exemption (TSBE) prevents any operator or potential operator from being excluded from the ticketing scheme without 'objective, transparent and non-discriminatory reasons' (see Article 6 of the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2001 (SI 2001 No 319)). The OFT has received no evidence to suggest infringement of the TSBE in this case.

³⁰⁴ Regardless of whether it is already a member of the MTC scheme as an interurban operator.

new entrant would need to at least subsidise the difference between the MTC ticket price and the price of Cardiff Bus' (urban) network ticket.³⁰⁵

6.41 Thirdly, under the mechanism for distributing MTC revenues to the scheme's participants, new entrants would indirectly finance Cardiff Bus, given its dominance of urban routes.³⁰⁶

6.42 The OFT therefore concludes that the MTC would not enable potential entrants to overcome Cardiff Bus' frequency and network incumbency.

iii. Cardiff Bus' ability to respond to new entrants

6.43 Finally, Cardiff Bus' extensive network may further strengthen its ability to deter entry by enabling it respond to new entrants competing on only part of the Cardiff Bus network. The NERA report³⁰⁷ suggests that, where incumbents operate integrated networks, entrants that are undifferentiated from the FSO incumbent have to enter on a large scale, because otherwise they would be selectively and economically targeted. This would prevent entrants from reducing operating costs or innovating sufficiently to be able to establish a foothold in the local market.³⁰⁸

6.44 In this respect, the requirement to register new local services with the relevant Traffic Commissioner with 56 days' notice (see paragraph 2.11)

³⁰⁵ For example, in its SSO, dated 20 May 2008, the OFT noted at footnote 305 that the (MTC) 'network day rider' was being sold at £6.00, compared to £3.50 for the 'day to go plus', which was limited to Cardiff Bus' buses (see <http://www.cardiffbus.com/fares/riders.htm>). This spread would entail a subsidy of £2.50 per ticket sold, because the MTC scheme member would need to pay the MTC scheme £6.00, despite receiving only £3.50 from the user.

³⁰⁶ Art. 11 of the Ticketing Schemes Block Exemption Order (TSBE) prevents multi-operator scheme distribution mechanisms from giving parties an incentive to set their fares higher than they would have been set in the absence of the scheme. Usually, revenues are allocated to reflect the typical/actual operational contributions of each scheme's participant – such as mileage operated, or patronage. See the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order, which came into force on 1 March 2001 and was amended by the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) (Amendment) Order 2005 (SI 2005 No 3347).

³⁰⁷ Pages 21-22 of the NERA report.

³⁰⁸ This ability thwarts one of the two fundamental requirements of market contestability according to the literature: that the incumbent is unable to react quickly enough to prevent an entrant's hit-and-run strategy (the other, more frequently referred to, assumption being the absence of entry and exit barriers).

may act as a barrier to new entrants, by providing incumbents with advance notice and the ability to redeploy resources in a pre-emptive and targeted way.

- 6.45 Furthermore, the ability to circumvent the 56-day requirement by registering routes as frequent routes is only open to operators already running buses on routes at sufficient frequency for them to be considered 'frequent' (at least every 10 minutes). This favours incumbents, because it requires entry on a scale sufficient to overcome the barrier.

iv. Conclusion on network effects

- 6.46 On balance, considering the above factors in the round, the OFT concludes that Cardiff Bus' network acts as barrier to entry and expansion in the relevant market – especially for potential competitors adopting a full service operator model.

E Costs of entry

i. Demand-side network effects

- 6.47 As explained in the previous Section, the presence of demand-side network effects of which Cardiff Bus can take advantage, would force a full-service bus operator to reach a large scale to compete effectively. The CC has noted³⁰⁹ that entry on a network basis would seem necessary if a new entrant is to withstand responses on individual routes or to compete with the network tickets offered by the incumbent. Similarly, the NERA report noted³¹⁰ that only via large scale, multi-market entry, might an entrant deprive the incumbent of its multi-market advantage (for instance in terms of its frequency and network incumbency), and thus avoid being selectively targeted.

³⁰⁹ See *FirstGroup plc and the Scottish Passenger Rail franchise*, CC Report, June 2004, paragraph 5.69.

³¹⁰ Page 22 of the NERA report.

6.48 In terms of costs, the evidence suggests that small scale entry may be feasible. In this case, Cardiff Bus stated that:³¹¹ 'A new competitor would simply need to demonstrate to the Traffic Commissioner that there is sufficient working capital to operate the bus services, adequate maintenance facilities are in place (which may be sub contracted), that there is hard standing available to park the buses, and that registrations have been submitted. The operator would then need to employ staff to drive the buses (the costs of which can be as low as £[...][C] per vehicle)'. Cardiff Bus estimated that: '...it could be possible to establish a new operation for less than £[...][C], with perhaps £[...][C] for working capital'. It further stated³¹² that a '...significant amount' of these costs would be 'reasonably recoverable' upon exit.

6.49 However, the OFT considers that large scale entry would incur substantial up-front fixed and common costs (some of which would be sunk),³¹³ which entail the presence of economies of scale and scope. In this respect, the OFT report on switching costs³¹⁴ noted that when switching costs are non-negligible but not too large, the presence of scale economies is likely to deter entry. Such switching costs can protect incumbents by making it hard for entrants to compete for attached buyers, while economies of scale would make it unattractive for the entrant to enter by selling only to unattached buyers. Scale

³¹¹ Letter to the OFT responding to the OFT's section 26 notice dated 17 August 2006.

³¹² Ibid.

³¹³ Sunk costs refer to those costs which must be incurred to compete in a market, but which are not recoverable on exiting the market. Entry and expansion will only occur if the expected profit from being in the market exceeds any sunk cost of entry/expansion. The expected profit from being in a market would also account for the possibility that exit occurs and that any associated 'exit costs' are incurred.

³¹⁴ See pages 38 to 39, paragraphs 5.19 to 5.20 of Appendix A of the OFT report on switching costs. This states that: '...Although, in general, moderate switching costs are conducive to at least small-scale entry, an exception is when there are very strong economies of scale in a market. These economies of scale may mean that the incumbent's cost advantage is so great that it is able both to price substantially above its own cost, while at the same time pricing lower than a new entrant's cost. The result is likely to be deterred entry. If the per capita economies of scale are greater than the per capita switching cost, then the incumbent can succeed in keeping the entrant out, despite the entrant's willingness to price below cost. As the incumbent's cost advantage due to economies of scale is greater than the switching cost consumers would pay to change firm, it is able to harvest the benefits from the switching cost while at the same time pricing so as to exclude the entrant...These strong economies of scale combined with switching costs give rise to what is known in economics as 'network effects'.

economies and switching costs therefore reinforce each other in deterring entry (regardless of what proportion of fixed and common costs is sunk).³¹⁵

6.50 In terms of start-up costs, third parties informed the OFT that on a large scale, these would be materially high:

- [...] [C] told the OFT³¹⁶ that in order to provide urban services in Cardiff it would be necessary to establish new depot facilities. It would also need to invest in new staff (maintenance and drivers) as well as possibly more vehicles.
- [...] [C] highlighted similar issues,³¹⁷ stating that for it to expand in Cardiff it would need to open a new depot. It estimated that a 'simple' depot would cost around £100,000 to set up and £500,000 to run.
- [...] [C] noted³¹⁸ that the costs of entry would be very high, stating that: 'It is our opinion that you could not start such an operation with less than ten buses, and these would need to be relatively high quality. This would cost £1 million and the utilisation would certainly be lower than that currently obtained in our own area...Much of Cardiff has been affected by traffic management making innovation difficult, and where apparent gaps in the network occur, these are found to be the result of urban village creation where streets are blocked off to all but local traffic. The result of this set of circumstances would result in poor profit margins, as we would be acting in a market that had little spare capacity, and would require at least £2 million expenditure in the first year. There would be peripheral effects on our own labour costs and the learning curve for management would be steep, given

³¹⁵ See R. Preston McAfee, Hugo M. Mialon, Michael A. Williams, *What is a barrier to entry?*, *The American Economic Review*, vol. 94(2), Papers and Proceedings of the One Hundred Sixteenth Annual Meeting of the American Economic Association San Diego, CA, 3 to 5 January 2004 (May 2004), pp. 461-465.

³¹⁶ [...] [C]

³¹⁷ [...] [C]

³¹⁸ [...] [C]

the regulatory requirements as regards timetables and maintenance. It is our view that we shall compete, as we do, on style of bus and level of service, but to proceed from a [...] [C] operation to a City Operation would require an inordinate level of expenditure to capture a small level of the market'.

- 6.51 Large scale entry would require more investment. For example, [...] [C] told the OFT³¹⁹ that establishing a new network of services would, in addition to the costs noted above, require 'fuel and wash equipment', office equipment and IT support, a fleet of vehicles together with driving, engineering, supervisory and management staff, and driver wash room facilities in the centre of Cardiff. [...] [C] also stated³²⁰ that in order to establish a new urban route it would also have to invest in roadside publicity and marketing.
- 6.52 Some of these costs would be recoverable on exit. For example, there is an active market for second hand buses,³²¹ and it also seems likely that a proportion of the cost of a new depot could be recouped through its sale on exit to another bus operator or land developer. It might also be possible to sell serviceable office and IT equipment on exit, as well as washroom facilities, although it is questionable whether their whole cost would be recovered. However, publicity and marketing costs, administrative costs incurred in planning and setting up services and staff training, cannot be recovered on exiting the market and should therefore be considered as sunk.³²²
- 6.53 Overall, the evidence indicates that large scale entry could incur significant fixed and common costs, some of which would be sunk,

³¹⁹ [...] [C]

³²⁰ Ibid.

³²¹ Trade publications for the bus industry such as 'Route One' and 'Coach and Bus Weekly' routinely include a number of advertisements for second hand vehicles, which suggests that there is an active market for the sale of such vehicles. Cardiff Bus provided the OFT with a schedule showing the proceeds of disposals which indicated that Cardiff Bus disposed of at least thirty vehicles in the year ended 31 March 2005. Appendix C Schedule of disposals provided to the OFT on 13 January 2006.

³²² In particular, the first two items may be considerable, given the implied large scale of operation (requiring the coordination and promotion of routes and schedules from different termini along the main corridors).

such as marketing and administration. These costs entail considerable economies of scale and scope to compete effectively, which, in combination with switching and shopping costs, may deter entry by full-service bus operators.

6.54 Furthermore, operators not running frequent services are also required to give 56 days' notice to the Traffic Commissioners before stopping services (see paragraph 2.11). If an entrant is making losses they are therefore, in principle, committed to making these losses for two further months before they can exit. This may increase the perceived risk of entry for potential competitors.

ii. Depot availability

6.55 Bus operators primarily organise themselves around their depots. The location, size and facilities available at the depot will have a considerable bearing on the bus services that the operator can provide. This Section therefore considers the extent to which competing bus operators at the time, with depots in the surrounding area, might have been able to expand their services and thus potentially act as a constraint on the operations of Cardiff Bus. It also considers the extent to which depot sites to serve the relevant markets may have been available.

6.56 As noted in the previous Section, establishing a new bus service in Cardiff may require significant investment in depot facilities. Some of the existing competitors told the OFT that they would need to open a new depot in order to expand their existing operations or commence new services in Cardiff. In some cases this was because existing depots were at capacity, and in other cases existing depots were located too far from Cardiff to be viable bases for operations into Cardiff. Under such circumstances, existing full-service bus operators would face similar up-front fixed and common costs, and thus have to reach the same economies of scale and scope, discussed in the previous Section, in order successfully to expand their operations into Cardiff.

6.57 As discussed in Annexe 2, the further a depot is from Cardiff, the more 'dead mileage' the vehicles must run to and from the route, and the more difficult it is to provide reliable cover for breakdowns. The OFT notes that previous CC reports have concluded that bus operators can provide services within a five- to 10-mile radius of their depot in urban areas.³²³ The OFT also notes that in *Chester v Arriva* the High Court referred to 30-minute isochrones, which is the same approach adopted by the OFT in its analysis in Chapters 4, 5 and Annexe 2. As demonstrated in Annexe 2, these two criteria lead to substantially overlapping results.

6.58 However, for the purposes of identifying all possible competitive constraints on Cardiff Bus, the OFT has considered the possibility of expansion from all operators included as part of the network market analysis. In this respect:³²⁴

- [...] [C] told the OFT³²⁵ that while it might be possible to run a service into Cardiff from [...] [C], in practice it was not desirable to do so due to the additional driver, fuel and breakdown costs. Indeed, it told the OFT that it could not operate an urban Cardiff service from outside Cardiff because of these costs. In summary, although it had not ruled out expanding services in the Cardiff market, it stated it would be unable to do so from its current depot and that expansion into the Cardiff market would require the purchase of depot and maintenance facilities closer to Cardiff. [...] [C] believed that potential depot sites were limited.
- [...] [C] told the OFT³²⁶ that its main depot was located some distance away from Cardiff [...] [C], and was already operating at capacity. Therefore, in order to compete in Cardiff it would need to open a new depot in Cardiff. [...] [C] identified this lack of suitable

³²³ *First Bus and SB Holdings Limited: a report on the merger situation*, 1997 (Cm3531).

³²⁴ Although these comments were made to the OFT after the time of the operation of the white services, the OFT does not consider there to be any reason for doubting, in the circumstances of the present case, that the comments were equally relevant to the situation in the market at the time.

³²⁵ [...] [C]

³²⁶ [...] [C]

depot facilities as a problem that it would have to overcome in order to supply bus services in Cardiff city. [...] [C] stated that it had previously spent some time looking for a potential site for a new depot in Cardiff, in order to see whether it could expand a tendered school service to provide commercial services as well, but had been unsuccessful in its search.

- [...] [C] told the OFT³²⁷ that: '...if we could be assured of protection we would introduce a limited number of suburban services and expand over a period of time to cover the whole of Cardiff'. [...] [C] views are considered further at paragraph 6.69.
- [...] [C] told the OFT³²⁸ that in its view it was feasible to operate a service within Cardiff from a depot outside of Cardiff, because fuel duty rebate was available up to the first stop in Cardiff. However, [...] [C] also stated that although land was available for depot facilities it was difficult to get planning permission, and that the Council tended to place conditions on planning permission which increased costs to the extent that it was not worth opening a new depot.
- [...] [C] commented³²⁹ that: '...the availability of depots close to bus routes is important because it limits the number of dead miles travelled from the depot to the start of a route. However, in the case of Cardiff it is not a significant constraining factor. This can be contrasted with London'. However, [...] [C] also stated that its '...current method of entry into a new market is primarily via the acquisition of an existing operator'.
- Of the other operators contacted by the OFT, only [...] [C] made any relevant observations on this point, commenting that:³³⁰ 'There are very little commercial premises available to use in Cardiff at reasonable prices and also people prefer not to lease premises to people in the transport industry'.

³²⁷ [...] [C]

³²⁸ [...] [C]

³²⁹ [...] [C]

³³⁰ [...] [C]

- 6.59 This suggests that depot facilities are necessary to operate commercial services in Cardiff, even for existing bus operators willing to expand on a full-service basis into Cardiff.
- 6.60 Moreover, the fact that some operators said that they had been unable to find a suitable site for a depot indicates that depot availability can pose a barrier to entry and expansion. In this respect, Cardiff Bus provided the OFT with a copy of Cardiff Council's Land Availability Digest for the period from July 2000,³³¹ which it considered³³² provided '...a good indication of available land in 2003 and 2004, and showed that a wide range of land parcels were available at the time'. The Digest listed 44 sites as at 1 July 2000, totalling 283 hectares.
- 6.61 Given that the 2000 Digest was produced nearly four years before Cardiff Bus introduced its white services, the OFT requested the equivalent document from Cardiff Council listing the available sites as at 1 July 2004. The OFT considers that this document³³³ provides a more accurate picture of the information on sites available to potential competitors at the time.
- 6.62 The OFT notes that by July 2004, the total number of sites listed had fallen from 44 in 2000 to 32. It also notes that of these sites 28 had extant planning permission and that most sites were described as 'small' (less than 1.2 hectares). In terms of potential entry by an FSO seeking a depot on approximately the same scale as Cardiff Bus, only eight possible sites appeared to be equivalent to, or larger in size than the site occupied by Cardiff Bus' depot at Sloper Road.³³⁴

³³¹ Cardiff Business and Industrial Landbank Monitoring, July 2000. This Digest describes its purpose as to: '...provide an accurate and up to date picture of the full range and choice of business and industrial land allocations and consents in the County in terms of location, size, ownership and where specified the permitted use class of individual sites both as an aid to planning policy formulation, and a guide to the development industry. The schedule is updated at six monthly intervals when any take up of land is identified, and new permissions introduced'.

³³² Letter to the OFT dated 21 January 2008.

³³³ Cardiff Business and Industrial Landbank Monitoring, July 2004.

³³⁴ Based on press reports (see South Wales Echo, 21 December 2007), the OFT has calculated that Cardiff Bus' depot at Sloper road is 2.8 hectares.

6.63 The OFT has not considered further the viability of the sites listed in the Digests (some of which may have been inappropriate for use as a bus depot). However, the OFT does not consider such analysis would be necessary to conclude that, while the number of sites was unlikely to be as substantial as might be implied by the 2000 Digest, it is possible that there may have been at least some sites large enough to accommodate a potential competitor entering on a full scale. Nevertheless, regardless of whether or not viable sites might actually have been available, the OFT notes that many of the other operators perceived a lack of depot availability to be a potential barrier to entry (see paragraph 6.58).

F Reputation for aggressive response to entry

6.64 For the reasons discussed above in Sections D and E, although the frequency of Cardiff Bus' services, together with its network incumbency, give rise to significant barriers to entry for operators adopting an FSO approach (because the investment needed to enter into competition with Cardiff Bus in that way would be high), this is less likely to be true in relation to no-frills approaches on a small scale (for example, on particular routes).

6.65 This is because, while Cardiff Bus' network and frequency advantages could be challenged only by an FSO competitor on the basis of large scale entry, entry on a small scale no-frills basis, targeting new or non locked-in (uncommitted) customers,³³⁵ would be less difficult, because it would enable the competitor to compete with Cardiff Bus' services without incurring the costs and risks of large scale entry. By adopting a no-frills model an entrant might avoid the barrier posed by the incumbent's network advantages, by segmenting the customer base and offering discounted fares to consumers who were price-sensitive but not time-sensitive. In particular, by providing services at non-peak hours with a lower frequency and at a discounted price, no-frills operators

³³⁵ Locked-in customers are those who have high switching costs.

could target those price-sensitive consumers willing to trade off schedule inconvenience for a lower price.³³⁶

- 6.66 Any undertaking that was considering entering into competition with Cardiff Bus in that way would, however, be likely to take account of whether and how Cardiff Bus would be likely to respond.
- 6.67 The OFT has therefore considered whether or not the available evidence demonstrates that an operator considering whether to enter into competition with Cardiff Bus in that way would be likely to anticipate an aggressive response by Cardiff Bus to that entry. As the NERA report observed³³⁷ in its assessment of various case studies, an incumbent's '...reputation for aggressive response to entry, combined with an awareness of the increasing disparity in depth of pocket compared to larger operators, acts to discourage small scale entry in this industry'. The OFT therefore sought information from other bus operators as to their perceptions of Cardiff Bus in terms of whether it was perceived as having a reputation for adopting an aggressive response to new entry.
- 6.68 Larger bus operators (which may be considered to be potential competitors to Cardiff Bus) told the OFT that they were generally unconcerned about any reputation that Cardiff Bus might have:
- [...][C] stated³³⁸ that it did not believe that Cardiff Bus had a reputation of dissuading entry through abusive behaviour, although it would expect an aggressive reaction by anyone in the face of expansion/new entry. It also told the OFT, however, that in the case of Cardiff, the presence of a large incumbent with a modern fleet operating a high frequency service was a significant barrier to entry. It would also expect Cardiff Bus, like any other incumbent, to react to any market entry.

³³⁶ Off-peak trips tend to include leisure, shopping and personal business trips for which there is usually greater flexibility in terms of destination and time – which suggests that off-peak price elasticities are likely to be higher. In the UK, off-peak elasticity values are about twice the peak values. See: *The demand for public transport: a practical guide*, TRL report, 2004, section 3.1.6.

³³⁷ Page 23 of the NERA Report.

³³⁸ [...][C]

- [...] [C] did not hold a strong view³³⁹ on Cardiff Bus' reputation, although it commented that it would expect Cardiff Bus to lower its fares or introduce timetable changes in response to new entry.
- [...] [C] stated³⁴⁰ that it had no particular concerns in respect of Cardiff Bus' reputation and, correspondingly, that this would not deter it from expanding its bus services in Cardiff. However, [...] [C] also clarified that, given its external growth strategy focused on acquisition of existing operators, its entry into a new market would not 'add' competition to existing operators, and therefore it would not expect it to trigger a particularly negative reaction.

6.69 Smaller operators, however, did appear to perceive Cardiff Bus as being likely to adopt an aggressive response, and regarded that reputation as a factor discouraging entry. For example:

- [...] [C] told the OFT³⁴¹ that it had: '...considered and would like to operate more services within Cardiff but have not because of the threat that Cardiff Bus could bring to our operation'. Having seen the way that Cardiff Bus reacted to other competition, [...] [C] was convinced that Cardiff Bus would come out in competition with [...] [C] commercial route, and it considered that Cardiff Bus' reputation was the main factor that prevented [...] [C] from expanding in Cardiff.
- [...] [C] told the OFT³⁴² that it would operate more services in Cardiff but for Cardiff Bus' likely response, and it considered that Cardiff Bus' reputation and ability to respond quickly to new competition acted as a barrier to entry.

³³⁹ [...] [C]

³⁴⁰ [...] [C]

³⁴¹ [...] [C]

³⁴² [...] [C]

- [...] [C] told the OFT:³⁴³ 'Cardiff bus has a reputation for responding aggressively to competition and this does defer us from starting new service in the Cardiff area'.

6.70 The OFT notes that these comments were made in 2006 and 2008, and might, therefore, to some extent be influenced by the events in 2004/05 that form the subject matter of this Decision. 2 Travel and [...] [C] alleged, however, that Cardiff Bus had, before 2004, engaged in conduct which enabled it to establish a reputation for aggressive response to any new entrant to the market.

6.71 In that regard, 2 Travel alleged³⁴⁴ that in 1995 a company called Bluebird started operations in Cardiff and that Cardiff Bus had responded by increasing the number of scheduled services, effectively flooding the market until Bluebird withdrew.

6.72 2 Travel also alleged that in 1999 a small company called Allisters of Barry started to run services in Cardiff on a very small scale. In particular, it told the OFT that:³⁴⁵ '...on this occasion, Cardiff Bus did employ the same tactics as it used against 2 Travel, running white services immediately in front of and behind Allisters buses rather than to a timetable. As far as 2 Travel is aware, this was the first time that Cardiff Bus employed such tactics, and it believes that the buses were purchased specifically for this purpose'.

6.73 The OFT notes that this allegation is corroborated by an article in the Bus Industry Monitor in 1999, which stated that Cardiff Bus: '...introduced a low cost operation...to tackle the competition on several corridors'. The Bus Industry Monitor further stated that: '...the low cost unit successfully accounted for the operations of Allister's Coaches in March 2000'.³⁴⁶ Allister's withdrew from the market in 2000.³⁴⁷

³⁴³ [...] [C]

³⁴⁴ Letter to the OFT dated 11 February 2005.

³⁴⁵ Ibid.

³⁴⁶ Bus Industry Monitor 2002, TAS Publications and Events Ltd.

³⁴⁷ Letter from 2 Travel to the OFT dated 11 February 2005.

6.74 [...] [C] alleged that Cardiff Bus had employed similar tactics against a company called Bluebird in 1995 and against Allisters in 1999. He alleged that in both cases Cardiff Bus' tactics included [...] [C]³⁴⁸ In addition, [...] [C] noted that other operators, such as CK Coaches and Bluebird, had competed unsuccessfully with Cardiff Bus, with the latter subsequently selling its operations to Cardiff Bus.³⁴⁹

6.75 [...] [C]^{350 351}

6.76 These allegations made by 2 Travel and [...] [C] relate to alleged conduct on the part of Cardiff Bus prior to the time of the operation of the white services considered in this case. 2 Travel and [...] [C] have not provided any evidence which would enable the OFT to reach any firm conclusion as to whether the alleged conduct actually occurred, and the OFT has neither made, nor sought to make, any detailed inquiries into the accuracy, or otherwise, of those allegations. The OFT does not, therefore, rely on the truth of the content of those allegations in connection with this Decision.

6.77 Nevertheless, the OFT considers that the fact that 2 Travel and [...] [C] believed, whether rightly or wrongly, even before 2004 that Cardiff Bus had previously adopted an aggressive approach to new entry in the past must have created a material disincentive to smaller operators entering into new small scale no-frills competition with that company's services. This is supported by the evidence provided by the 2006 interviews that Cardiff Bus continues to have that reputation among smaller operators, albeit that that reputation may to some extent relate to the 2004/05 events.

³⁴⁸ [...] [C]

³⁴⁹ [...] [C]

³⁵⁰ [...] [C]

³⁵¹ In this regard, the OFT notes that in the current investigation Cardiff Bus submitted to the OFT a strategy document concerning its response to 2 Travel's entry into the market (see Cardiff Bus internal document entitled 'Competition policy' dated 24 March 2004, provided in response to the OFT's section 26 notice dated 26 May 2005). This document (discussed further in Chapter 7) refers to using fighting buses, reducing fares, increasing frequencies and running vehicles ahead of its competitor's services. [...] [C]

- 6.78 Furthermore, these shared perceptions seem consistent with Cardiff Bus' own expectations at the time. The OFT notes that a report, produced in February 2005 by Cardiff Bus' independent auditors Deloitte & Touche LLP (the 'Deloitte report')³⁵² to review the 'mechanical accuracy' of a five year plan prepared earlier by Cardiff Bus' Board of Directors, noted that this Plan included an assumption agreed by the Directors that Cardiff Bus would face '...no competition during the life of the plan'. The Plan was endorsed by Cardiff Bus' Board of Directors on 30 November 2004.³⁵³
- 6.79 In its written representations on the SSO,³⁵⁴ commenting on the Deloitte report, Cardiff Bus stated that: 'The OFT has drawn an inference that is wholly incorrect. The statement [that Cardiff Bus would '...face no competition' over the lifetime of the five year plan] is not what Cardiff Bus were expecting. It is merely an assumption made for accounting purposes and qualifies the plan. The effect of the assumption is to highlight that the revenues assumed in the plan are dependant on there being no competition in the five years. Therefore to the extent that Cardiff Bus does face competition the revenues will be affected by the extent of that competition. Without making such assumptions it would be very difficult to conclude a five year plan given the uncertainties about what would happen in the future'.
- 6.80 However, the OFT notes that the assumption of no competition was selected as appropriate by Cardiff Bus itself for its own five year plan. Furthermore, the Deloitte report included caveats that: '...The directors are responsible for the above assumptions' and that the '...scope of the report was limited solely to the procedures set out above'.³⁵⁵ Given the importance of the five year plan to Cardiff Bus' plans for significant investment over that period, the OFT considers that had Cardiff Bus

³⁵² Deloitte & Touche LLP, *Report to the Board of Directors of Cardiff Bus*, dated 10 February 2005, page 1. This is referred to as the 'Deloitte report' in this Decision.

³⁵³ Managing Directors report of 30 November 2004 and minutes of the meeting of the Board of Directors held on 30 November 2004.

³⁵⁴ Cardiff Bus' written representations on the OFT's SSO, page 15, paragraph 3.4.

³⁵⁵ Deloitte & Touche LLP, *Report to the Board of Directors of Cardiff Bus*, dated 10 February 2005.

been expecting to face competition it would have based its assumptions on such a scenario, rather than on an assumption of no competition. At the very least, the OFT would have expected Cardiff Bus to have considered an alternative scenario with competition, or how sensitive its plans were to the threat of potential competition and what contingency might be required. The Deloitte report contains no consideration of how competition might affect the plan. The absence of any such consideration in its planning suggests that Cardiff Bus did not anticipate facing any competition, as is clearly stated in the Deloitte report.

G The history of entry and exit, and expansion plans

- 6.81 In considering the potential for competition, it is instructive to consider the history of entry, expansion and exit before and after the events which form the subject matter of this case. This Section also considers the attitudes of potential competitors to possible entry or expansion in the market.
- 6.82 The evidence suggests that, with the exception of 2 Travel, there has been no substantial market entry or exit since at least 2000, and there is no evidence that large FSOs are considering entry or expansion - indeed, Cardiff Bus itself expects to face no competition.

i. The history of entry, exit and expansion

6.83 The evidence available suggests that, other than 2 Travel's short-lived attempt to enter, there has been no substantial market entry or exit since at least 2000.³⁵⁶ Furthermore, the responses from third party bus operators already operating in or near Cardiff (in some cases having acquired other operators), suggested that there had been limited expansion of, or changes to, their commercial services:

- **Veolia** stated³⁵⁷ that it had not started to provide any new routes in Cardiff since acquiring Bebb Travel and Shamrock Travel in 2005 and 2006 respectively. Veolia also stated that it had withdrawn, surrendered or lost a number of tendered contracts which were previously being operated by Bebb Travel or Shamrock Travel.
- **First** stated³⁵⁸ that it had commenced the operation of school contracts in Cardiff in September 2006 and had expanded the operation to 14 contracts in September 2007. It also began to operate one local bus service in Cardiff on behalf of the Vale of Glamorgan Council in December 2007.
- **Stagecoach** stated³⁵⁹ that its routes had generally remained unaltered since it acquired Glyn Williams Travel.
- **EST** stated³⁶⁰ that since 2003, it had introduced two new commercial services which covered parts of services operated by

³⁵⁶ Cardiff Bus' response dated 15 September 2006 to the OFT's section 26 notice dated 17 August 2006 indicated that: 'During the period from April 2003 to present, other than 2 Travel, no other operators that Cardiff Bus is aware of have established bus services in Cardiff and Cardiff County, and none of the existing operators have left'. In its response dated 21 January 2008 to a subsequent OFT section 26 notice dated 20 December 2007, Cardiff Bus also indicated that: 'On the basis of the records available to Cardiff Bus the only entry into the Cardiff County area between January 2000 and April 2003 was: (a) 6 August 2001, a company called Cled's Super Minis from Bargoed operated supported Services 6 and 33B for Cardiff County Council. This operator ceased sometime in 2002 on the loss of its 'o' licence at which time these services passed to the established Bebb operation; (b) April 2002 Cardiff Council supported services 98 and 99 operated by 2 Travel'.

³⁵⁷ Letter responding to the OFT's section 26 notice dated 21 December 2007.

³⁵⁸ Letter responding to the OFT's section 26 notice dated 21 December 2007.

³⁵⁹ Letter responding to the OFT's section 26 notice dated 21 December 2007. Stagecoach acquired Glyn William Travel in approximately May 2006 (source: note of telephone conversation with Stagecoach, 15 February 2007).

Cardiff Bus. It had also introduced five new tendered services since 2004. However, these new services (both commercial and tendered) operated at a frequency of one service every one to two hours.

ii. The attitudes of potential competitors to future entry and expansion

6.84 As noted at paragraphs 6.78 to 6.80, Cardiff Bus itself was not expecting any further entry or expansion into its area. There is also no evidence that large full-service bus operators were considering entry and expansion into the market through competition:

- [...] [C], which is one of the largest operators of bus services in the UK³⁶¹ and which would have significant financial resources and expertise at its disposal should it wish to expand its services within Cardiff, stated in a section 26 response³⁶² that its strategy in Cardiff is to focus on: '...improving interurban services into Cardiff to provide strong network of service on key corridors, rather than establishing a network of urban services'. [...] [C] stated³⁶³ that it had not ruled out competing in Cardiff but it did identify a number of barriers to it doing so, in particular, a lack of suitable premises. In response to a further section 26 notice³⁶⁴ [...] [C] also noted the high cost associated with winning a sustainable market share.³⁶⁵
- [...] [C] has operated school contracts in Cardiff since [...] [C]. It expanded in [...] [C], and has recently commenced another local

³⁶⁰ Email responding to the OFT's section 26 notice dated 21 December 2007.

³⁶¹ [...] [C]

³⁶² [...] [C]

³⁶³ [...] [C]

³⁶⁴ [...] [C]

³⁶⁵ While citing depot availability as a barrier to expansion, [...] [C] acknowledged that it had not produced any detailed business case for opening a new depot in Cardiff and thus lacked actual information as to whether availability or cost of land for a depot site would have been a significant barrier to expansion (ibid). This, however, also suggested that it had little immediate interest in expanding internally (through competition) into Cardiff.

service in Cardiff [....][C]. However, it had no plans to expand into Cardiff until at least [....][C].³⁶⁶

- [....][C] commented³⁶⁷ that it would like to expand, but felt it was difficult to do so, given the dominance of Cardiff Bus in the Cardiff area.
- [....][C] stated³⁶⁸ that it would be rare for it to start operations in a town where there was an established operator, because the investment would probably not meet its financial criteria for investment.
- [....][C] commented³⁶⁹ that it had not to date discussed internally or prepared any written proposals or business plans to enter Cardiff. Its current long-term Business Plan might include long-term expansion plans for Cardiff, but at present did not. However, [....][C] also explained that its business model was, in any case, to enter by acquisition.

H Cardiff Bus' ownership and governance

6.85 As noted in paragraph 5.6, market power can be described as the ability profitably to sustain prices above competitive levels or to restrict output, innovation, or quality below competitive levels. In its written representations on the OFT's SO,³⁷⁰ Cardiff Bus contended that it was not dominant and that this was demonstrated by the lack of evidence of market power in the form of high prices, low quality and/or reduced output.

6.86 In this respect, the OFT notes that, since November 2003, Cardiff Bus has increased the cost of a Zone 1 adult single ticket by 85 per cent and

³⁶⁶ [....][C]

³⁶⁷ [....][C]

³⁶⁸ [....][C]

³⁶⁹ [....][C]

³⁷⁰ Cardiff Bus' response of 7 August 2007 to the OFT's SO dated 15 May 2007, section 4.2, pages 28 to 30.

the cost of a child single ticket by 100 per cent.³⁷¹ See also paragraph 7.256 which benchmarks Cardiff Bus' fare increases against the industry averages since 2002/03. The OFT also notes the comments in the 2006 TAS report for Cardiff Bus that: 'The majority of single and return tickets users are not using day tickets because they do not feel that purchase is financially worthwhile...'³⁷² and '...that the Multiride range of tickets are relatively expensive compared to seasonal tickets in other UK cities that have a similar population to Cardiff'.³⁷³ This is discussed further in Chapter 7.

- 6.87 In any event, the fact that an undertaking cannot be shown to be charging high prices, generating high profits, or providing low quality goods or services, does not necessarily lead to a conclusion that the undertaking does not have market power. As noted above, the assessment of dominance is based on whether an undertaking has the **ability** profitably to sustain prices above competitive levels, not whether it actually prices at above those levels.
- 6.88 There may be a number of reasons why a dominant undertaking has not chosen to price above competitive levels. In this case, for example, if Cardiff Bus' prices were found not to exceed competitive levels, a potential explanation for this may be Cardiff Bus' ownership and governance arrangements.
- 6.89 As noted in paragraphs 2.22 to 2.25, Cardiff Bus is a wholly owned operating company of Cardiff Council established in October 1986 following the deregulation of the industry implemented by the Transport Act 1985. The Council owns all the shares in the company and is represented on Cardiff Bus' Board. Prior to deregulation, Cardiff Bus was wholly owned and operated by Cardiff Council.

³⁷¹ Source: Cardiff Bus fares booklet, 2 November 2003: Zone 1 Adult single fare was 65 pence; and Zone 1 child single fare was 40 pence. South Wales Echo, March 19 2008: article headed 'Cardiff Bus ups prices to maintain services', which states: '...new charges will take effect from April 6 and mean the cost of an adult single ticket in the city will rise from £1 to £1.20 while a child's single ticket will rise from 70p to 80p.' See: <http://icwales.icnetwork.co.uk/news/cardiff-news/2008/03/19/cardiff-bus-ups-prices-to-maintain-services-91466-20646496/>.

³⁷² The TAS report, paragraph 2.2.8.

³⁷³ Ibid.

i. Impact on competitors' incentive to enter or expand

6.90 Cardiff Bus' municipal ownership may affect the incentives for potential competitors to enter or expand in a number of ways.

6.91 As Cardiff Bus has itself stated,³⁷⁴ it has additional objectives beyond making profits. Cardiff Bus may therefore face less discipline to be profitable. In this regard, in its published report *Driving through the decades*,³⁷⁵ Cardiff Bus stated that: 'We have the commercial freedom to invest in services, equipment and the bus network to benefit our passengers and the people of Cardiff. We do not have to generate short term profits to pay dividends to private shareholders or financial institutions'. This report goes on to note that: '...each route must be commercially viable in its own right', but also that 'Cardiff Bus is unique in being a community owned operator willing to run services on much smaller profit margins than would be entertained by a private sector commercial operator'.

6.92 Cardiff Bus notes in the same document that: 'Cardiff Bus runs many services on much tighter margins than many private operators would consider worthwhile or even viable. Were the bus company not owned by Cardiff Council, then such services may well be reduced or even cut and the Council would face a much higher bill for tendered 'socially necessary' services'.³⁷⁶ Cardiff Bus has also stated that:³⁷⁷ '...its business model is very different from a normal private sector operator...its objectives include an extensive corporate social responsibility agenda'.

6.93 [...] [C] stated³⁷⁸ that the Council had provided bus lanes from the east of Cardiff, where Cardiff Bus services operated, but not from [...] [C] services operated. Furthermore, a number of bus operators suggested to the OFT that Cardiff Bus might have privileged access to information

³⁷⁴ Letter to the OFT dated 11 July 2005.

³⁷⁵ *Your bus company: Driving through the decades*, Cardiff Bus, 2006.

³⁷⁶ *Ibid.*

³⁷⁷ Letter responding to the OFT's section 26 notice dated 26 May 2005.

³⁷⁸ [...] [C]

held by the Council. [...] [C], for example, told the OFT³⁷⁹ that: 'Although Chinese walls were supposed to operate between Cardiff Bus and Cardiff Council, in practice this does not appear to happen'. In its response to a section 26 notice, [...] [C] also stated³⁸⁰ that: 'As Cardiff Bus is a wholly owned subsidiary of Cardiff County Council they have an unfair advantage over other operators. Whilst we have been assured in the past that "Chinese walls" exist our belief [is] that these have broken down and knowledge is readily passed from one to the other'.

6.94 A similar allegation was made by [...] [C],³⁸¹ which claimed that Cardiff Bus received advanced notice of competitor services. In illustration of this, [...] [C] cited a specific incident in which [...] [C] had told the Council of its plans to start a new route and Cardiff Bus shortly afterwards registered that route with the Traffic Commissioner.

6.95 The OFT notes that these are serious allegations, and that the operators who made them have not provided any substantive evidence to support those allegations. Further, the OFT has not investigated those allegations in detail and does not, therefore, rely on the accuracy of those allegations for the purposes of this Decision. Nevertheless, to the extent that other operators perceived that Cardiff Bus had an additional advantage due to its ownership by Cardiff Council, this is likely to have constituted a factor further reducing the likelihood of entry and/or expansion of competition against Cardiff Bus' services.

I Conclusion on potential competition

6.96 The potential for entry and expansion appears limited both at the network level and on individual routes. Cardiff Bus' frequency and network incumbency represents a very significant barrier to entry for full-service bus operators, because it requires the latter to enter at a large scale to overcome switching and shopping costs due to demand-side scale and scope economies in consumption. However, large-scale

³⁷⁹ [...] [C]

³⁸⁰ [...] [C]

³⁸¹ [...] [C]

entry implies substantial up-front fixed and common costs, some of which are sunk. These substantial costs of entry further contribute to discouraging large potential competitors from entering or expanding into Cardiff.

- 6.97 While it might be possible to overcome these entry barriers by adopting a differentiated no-frills approach at a small scale, such an entry/expansion model is deterred by Cardiff Bus' ability to, and its reputation among smaller operators for implementing, an aggressive response to new entry that would make it difficult for such entry to be successfully established.
- 6.98 For these reasons the OFT concludes that entry barriers are sufficiently high to prevent and/or deter entry and expansion into Cardiff on a sufficient scale to compete effectively with Cardiff Bus.

J Overall conclusion on dominance

- 6.99 In terms of actual competition, as discussed in Chapter 5, on the basis of its frequency shares, Cardiff Bus was by far the largest operator of bus services both on a flow-by-flow and network basis. Its rivals did not have sufficient presence on the relevant routes, either individually or collectively, to exert a significant constraint on it. Cardiff Bus was also by far the largest operator on a wider network basis. Furthermore, Cardiff Bus' independence from actual competitors was reinforced by low potential for supply side substitution.
- 6.100 Potential competition from train operators, in the short- to medium-term at least, was very unlikely and the potential for entry and expansion on the part of bus operators is also limited, both at the network level and on individual routes. Barriers to entry and expansion by existing bus operators include the strength of Cardiff Bus' network, the costs of entry, and Cardiff Bus' reputation for responding aggressively and selectively to entry or expansion on particular routes. Potential competition from this source is therefore limited.

6.101 Overall, taking the evidence in the round, the OFT concludes that the limited actual and potential constraints on Cardiff Bus at the time, support the conclusion that Cardiff Bus had sufficient market power to be able to act independently of its competitors, customers and consumers. Therefore, the OFT concludes that Cardiff Bus held a dominant position in the relevant markets.

7 Abuse

A Introduction

7.1 The previous two Chapters discussed the evidence underlying the OFT's conclusion that Cardiff Bus held a dominant position in the relevant markets at the time. This Chapter considers whether Cardiff Bus abused that dominant position by engaging in predatory conduct against 2 Travel.

7.2 The OFT considers that, for the reasons set out in this Chapter, there is sufficient evidence to demonstrate that Cardiff Bus' conduct was predatory and thus an abuse of its dominant position.

B Relevant conduct and legal framework

7.3 This Section sets out the nature of the conduct under consideration, as well as the legal framework within which the OFT has assessed this conduct. The Section also sets out the OFT's overall consideration on the basis of the legal framework and on the evidence which is subsequently detailed in the rest of the Chapter.

i. Relevant conduct

7.4 The facts of this case were set out in Chapter 2. In summary:

- By early November 2003, Cardiff Bus was aware that 2 Travel was likely to run commercial services on certain of Cardiff Bus' routes and began preparations to react to this new market entry.
- On the same day that 2 Travel started its no-frills services, Cardiff Bus started to introduce its own no-frills services (the white services), which:
 - were differentiated from Cardiff Bus' normal services in terms of livery and fares (although passengers who bought a return ticket on a white service could use those tickets to return on a normal service and vice versa), and

- operated during the same periods of the day as 2 Travel's services and on the same routes as those on which 2 Travel had registered to run its no-frills services.
- Cardiff Bus priced its white services at the prices shown at paragraph 2.52. Cardiff Bus' fares for its white services were below 2 Travel's for three out of four zones.
- Cardiff Bus withdrew its white services shortly after 2 Travel had exited the market.

7.5 As set out further below, the OFT has considered whether Cardiff Bus' conduct went beyond 'normal competition'³⁸² and was part of a strategy directed at excluding 2 Travel from competing directly with Cardiff Bus' normal services, thereby protecting and/or enhancing Cardiff Bus' existing dominant position.

7.6 In its complaint to the OFT, 2 Travel claimed, amongst other things, that Cardiff Bus operated its new white services at a loss with the intention of driving 2 Travel from the market. A significant aspect of Cardiff Bus' conduct that the OFT has taken into account in assessing whether or not that conduct was predatory has been the prices which Cardiff Bus charged for its white services, and the fact that the revenues generated by the introduction and operation of the white services fell well short of covering the additional costs incurred by Cardiff Bus in order to run those services.

ii. Legal framework

7.7 As discussed in Chapter 3, the concept of predatory conduct as a type of abuse of a dominant position has been considered by the European Court and the UK Competition Appeal Tribunal (CAT) in a number of cases. A particularly significant judgment of the CAT is that which was given in *Aberdeen Journals*, a case which concerned allegations of

³⁸² *Aberdeen Journals Ltd v Office of Fair Trading* [2003] CAT 11, at paragraphs 349 to 358.

predatory conduct arising from an undertaking's pricing practices.³⁸³ The CAT stated, after having considered the relevant EC case-law, that the assessment of whether a 'certain pricing practice' by a dominant undertaking was to be regarded as abusive should be assessed 'in the round'.³⁸⁴

7.8 In the same judgment, the CAT also stated³⁸⁵ that the assessment of whether a 'certain pricing practice' by a dominant undertaking is abusive should, in particular, take into account whether:

- the dominant undertaking has had '...recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators...', and
- '...whether such conduct has the effect of weakening or distorting competition in the relevant market, having regard to the special responsibility of a dominant firm not to impair genuine undistorted competition'.

7.9 The CAT considered that: '...these principles apply particularly to the case of a dominant firm facing new entry, where retaliatory measures going beyond what is reasonable and proportionate are likely to require close scrutiny under the Chapter II prohibition'.³⁸⁶

7.10 A dominant undertaking may be found to have set prices in a way that allows for predation to be presumed. In *AKZO*,³⁸⁷ for example, the European Court of Justice stated that, as a general rule, pricing below average variable costs (AVC), by means of which a dominant undertaking seeks to eliminate a competitor, must be regarded as

³⁸³ *Aberdeen Journals Ltd v Office of Fair Trading* [2003] CAT 11 ('*Aberdeen Journals*'), at paragraphs 349 to 358. The Tribunal cited, in particular, Cases C-62/86 *AKZO Chemie v Commission* [1991] ECR I-3359 and C-333/94P *Tetra Pak v Commission* [1996] ECR I-5951 ('*Tetra Pak II*').

³⁸⁴ *Aberdeen Journals Ltd v Office of Fair Trading* [2003] CAT 11, at paragraph 350.

³⁸⁵ *Aberdeen Journals Ltd v Office of Fair Trading* [2003] CAT 11, at paragraphs 349 to 358.

³⁸⁶ *Aberdeen Journals Ltd v Office of Fair Trading* [2003] CAT 11, at paragraph 350.

³⁸⁷ Case C-62/86 *AKZO Chemie v Commission* [1993] 5 CMLR 215, paragraphs 71 and 72.

abusive, since it would not normally be commercially rational for an undertaking to price at levels that did not even cover AVC.

7.11 As the CAT held in *Aberdeen Journals*, however, a dominant undertaking may, exceptionally, be able to rebut this presumption.³⁸⁸ Thus, depending on the facts of the case, pricing below AVC might not be found to constitute an abuse if, for example, there is an objective justification for that pricing. The CAT added, however, that in its view: '...the presumption of abuse will rarely, if ever, be rebutted if the pricing policy under scrutiny originates as an aggressive response to market entry by a competitor, or is directed towards eliminating a competitor. An objective justification will normally be particularly difficult to establish if there is evidence of selective price cutting by a dominant undertaking that is targeted specifically towards the customers or potential customers of a competitor...'.³⁸⁹

7.12 As is well recognised, the categories of abuse under Article 82 and also Chapter II are not limited. For example, the European Court of Justice held in *Compagnie Maritime Belge*:³⁹⁰ 'It is settled case-law that the list of abusive practices contained in Article 86 of the Treaty is not an exhaustive enumeration of the abuses of a dominant position prohibited by the Treaty (Case 6/72 *Europemballage and Continental Can v Commission* [1973] ECR 215, paragraph 26). It is, moreover, established that, in certain circumstances, abuse may occur if an undertaking in a dominant position strengthens that position in such a way that the degree of dominance reached substantially fetters competition (*Europemballage and Continental Can*, paragraph 26)...Furthermore, the actual scope of the special responsibility imposed on a dominant undertaking must be considered in the light of the specific circumstances of each case which show that competition has been weakened (Case C-333/94 P *Tetra Pak v Commission* [1996] ECR I-5951, paragraph 24)...It follows that, where a liner conference in a

³⁸⁸ *Aberdeen Journals Ltd v The Office of Fair Trading*, [2003] CAT 11, paragraph 357.

³⁸⁹ *Aberdeen Journals Ltd v The Office of Fair Trading*, [2003] CAT 11, paragraph 358.

³⁹⁰ Joined Cases C-395/96 P and C-396/96 P *Compagnie Maritime Belge Transports SA v European Commission*. Paragraphs 114 to 117.

dominant position selectively cuts its prices in order deliberately to match those of a competitor, it derives a dual benefit. First, it eliminates the principal, and possibly the only, means of competition open to the competing undertaking. Second, it can continue to require its users to pay higher prices for the services which are not threatened by that competition'.

- 7.13 In that case the purpose of the conduct complained of³⁹¹ was to eliminate the remaining competitor from the market.³⁹² In this case, the OFT has found not only that the addition of the white services on the selected routes carried the intent to eliminate a competitor,³⁹³ but also that the conduct in fact led to Cardiff Buses incurring losses, assessed on the basis of Average Avoidable Cost (AAC).³⁹⁴

C The OFT's consideration of Cardiff Bus' conduct

- 7.14 This Section summarises the approach the OFT has taken in Chapter 7 when considering the evidence on Cardiff Bus' conduct.
- 7.15 A dominant undertaking (which, by virtue of its position, has a special responsibility not to impair competition on the market) must not resort to methods other than 'normal competition' and adopt a strategy of using its economic strength and/or strong existing market position to drive out a new competitor. In the OFT's view, a dominant undertaking oversteps the marker laid down by the Chapter II prohibition where it adopts a strategy resulting in it incurring losses, without objective justification, in order to drive out the new competitor, and thus preserve and/or enhance the dominant undertaking's position.
- 7.16 In this case, Cardiff Bus did not choose to respond to competition from 2 Travel simply by reducing prices on its existing normal services. Instead, at almost exactly the same time, and on the same routes as 2

³⁹¹ Ibid, paragraph 120.

³⁹² The Court went on to make clear that the conduct in that case did not involve the definition of a new abusive practice.

³⁹³ See Sections E and F of this Chapter.

³⁹⁴ See Section F of this Chapter.

Travel had launched its services, Cardiff Bus launched its own no-frills white services. In other words, Cardiff Bus ran a differentiated product, which targeted the same consumers as those targeted by 2 Travel (bus users on the same routes who might be attracted to no-frills services).

7.17 The fact that 2 Travel launched no-frills services does not mean that Cardiff Bus was not permitted to launch its own no-frills services if it was pursuing a legitimate commercial objective in doing so (for example, if Cardiff Bus perceived that there was a demand for such services, and that to launch such services might result in Cardiff Bus generating increased profits as compared with the situation that would prevail if it did not launch such services).

7.18 In this case, the OFT has considered it appropriate to examine whether Cardiff Bus launched and operated its white services in pursuance of normal commercial objectives, or whether those services were, in fact, launched and operated as part of a predatory strategy of driving 2 Travel out of the market, after which the white services would no longer be needed and could be discontinued. In carrying out that examination, the OFT has looked at all the available evidence 'in the round', including:

- internal Cardiff Bus documents that demonstrate that Cardiff Bus planned to run no-frills bus services as a direct aggressive response to 2 Travel's entry,
- the evidence that Cardiff Bus' costs in launching and operating the white services exceeded any additional revenues earned through operating those services, and
- Cardiff Bus' representations in response to the SO and SSO, including the explanations for the launch of the white services which Cardiff Bus has provided, and the lack of contemporaneous evidence to support those explanations.

7.19 On launching its white service, Cardiff Bus was in a materially different position from 2 Travel in important respects. Unlike 2 Travel, Cardiff Bus was the incumbent operator with a large network of commercial and tendered services, including existing normal services on the routes on

which it chose to run the white services. As the incumbent, Cardiff Bus was likely to incur an opportunity cost as a result of some customers switching from its normal services to the white services (in terms of reduced core revenues), whereas 2 Travel faced no such opportunity cost. Furthermore, by running its no-frills services in-between its tendered services 2 Travel did not appear to incur incremental driver costs (see paragraph 7.116) unlike Cardiff Bus, which incurred significant additional costs when it established its new, separate and dedicated white service (see Section F).

- 7.20 There is clear evidence that the revenues generated by Cardiff Bus' white services failed to cover the costs of running those services. The revenues generated by the white services did not even cover the costs of paying the wages of the drivers who drove the white buses. The introduction of the white services resulted in Cardiff Bus incurring losses that it could have avoided had it not started its white services.
- 7.21 Cardiff Bus appears to have accepted that the white services were not a commercial success – indeed, as discussed later in this Chapter, Cardiff Bus claims that it withdrew the services for exactly that reason.
- 7.22 For a company to choose to launch new services that are likely to result in its generating losses (i.e. making lower profits overall than it would have done had it not launched those services) would not normally be commercially rational conduct on its part. Cardiff Bus submitted in its representations, however, that: '...the OFT's retrospective actual revenue based approach is not appropriate because the financial test applied cannot serve as an obvious indicator of the intention of Cardiff Bus when setting its prices. It was by no means obvious to Cardiff Bus when it started operating its white services that these would not be profitable'.³⁹⁵ In summary, therefore, Cardiff Bus has submitted that its white services were launched as a trial and, accordingly, it did not know whether these services would be commercially successful.

³⁹⁵ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 51, paragraph 6.7.

- 7.23 The OFT has given careful consideration to Cardiff Bus' explanation for its launch and operation of the white services. In that regard, the OFT accepts that, in principle, for the purposes of assessing whether a dominant undertaking's conduct was predatory, the rationality of the decision to engage in, or continue, that conduct should be judged on the basis of the facts as they would have appeared to the dominant company at that time. Depending on the circumstances of the case, therefore, it may not be appropriate to infer that conduct was predatory if there was a genuine attempt to market test new services which were considered to have a realistic prospect of success, but which ultimately proved not to be commercially successful.
- 7.24 On the other hand, the OFT also considers that claims by a dominant undertaking that conduct on its part at around the time of new entry into the market by a competitor was unintentionally loss-making cannot be taken at face value, and should be considered in the light of all the available evidence with a view to determining whether those claims are credible.
- 7.25 The OFT has therefore considered it appropriate to evaluate the explanation offered by Cardiff Bus (discussed further in Sections D and E) that its white services were launched as part of a genuine attempt to test the market. In doing so, as noted above, the OFT has considered the overall conduct of Cardiff Bus in introducing and operating the white services in the light of all the available evidence, including Cardiff Bus' pricing and contemporaneous internal and public documents.
- 7.26 Section E of this Chapter therefore considers the extent to which the available evidence supports Cardiff Bus' explanation for its conduct. In *Napp*, the CAT stated³⁹⁶ that: '...when a dominant undertaking selling below cost contends that its policy is not motivated by an intention to eliminate competition but is based on some other, legitimate, commercial rationale, the best way for that undertaking to defend itself is by producing contemporary internal documents showing that such a

³⁹⁶ *Napp Pharmaceuticals Holdings Limited and Subsidiaries v Director General of Fair Trading* [2002] CAT 1 at paragraph 251.

rationale did in fact form the basis of the company's policy at the material time'. By analogy, the OFT would have considered it reasonable to give appropriate weight to any internal documents, produced by Cardiff Bus in the lead-up to its decision to launch the white services, credibly evidencing the 'market testing' motive and/or demonstrating an internal view that the launch of those services could be profitable for Cardiff Bus.

7.27 As discussed in Section E, however, Cardiff Bus has been able to provide little in the way of contemporaneous documents to support its explanation that the white services were introduced to test market demand for no-frills services rather than merely to divert passengers from 2 Travel. It has produced only very limited evidence to the contrary, and in particular could provide no contemporaneous internal documentary evidence that it planned a genuine market test, nor that it had any expectation that the test might prove that white services would lead to its making more, or at least no less, profit overall, nor that it subsequently assessed the outcomes of such a test. In the OFT's view, it would be very unlikely for a company like Cardiff Bus to launch and to continue a market test of this kind without generating any internal documents making the business case for carrying out that test, or seeking to evaluate its results. In particular, there is no evidence that Cardiff Bus conducted any predictive assessment of whether the introduction of its no-frills services would have been profitable.

7.28 Section E also identifies evidence that contradicts Cardiff Bus' explanation that it was conducting a market test. This includes evidence that Cardiff Bus planned to launch no-frills white services in order to divert potential customers away from 2 Travel. There is also evidence that Cardiff Bus publicly disparaged the concept of no-frills services and avoided promoting them. In the OFT's view, the evidence considered as a whole does not support Cardiff Bus' explanation for its launch of the white services.

7.29 Further to this, the OFT has identified evidence that gives rise to a strong inference that Cardiff Bus launched its white service with exclusionary intent – in other words, with the intention of diverting

prospective customers away from 2 Travel and thereby forcing 2 Travel out of the market, thus protecting Cardiff Bus' dominant position, and not with the intention of competing on the merits or carrying out a genuine market test. Section E assesses the coincidence in the timing and routes of the white services with those offered by 2 Travel. In particular, the Section presents evidence of the substantial preparations made by Cardiff Bus to respond aggressively to 2 Travel's entry, as well as ongoing assessment by Cardiff Bus of the threat posed by 2 Travel. The Section demonstrates that Cardiff Bus' white services were planned as a retaliatory reaction to new entry by a competitor, with the intention of forcing that new entrant out of the market and thereby restoring the market to its previous state.

- 7.30 Section F sets out the evidence which, in the OFT's view, is sufficient to demonstrate that the launch and continued operation of the white services was loss-making for Cardiff Bus. In other words, that by launching and continuing the white services, Cardiff Bus was making less money than it would have done had it not launched or continued those services.
- 7.31 There is little evidence that Cardiff Bus ever considered the likely impact on its profits of launching the white services. Rather, the contemporaneous evidence suggests that Cardiff Bus simply wanted to divert passengers away from 2 Travel and did not consider whether or not the white services would be profitable in their period of operation. In the OFT's view, this failure to consider whether the white services would be profitable does not undermine, but rather supports, a conclusion that the launch of those services was motivated by predatory intent. Once the white services were running, it would have quickly become evident to any objective observer in the position of Cardiff Bus that the services as run were loss-making and a commercial failure.
- 7.32 In all the circumstances, the OFT concludes that the evidence is sufficient to demonstrate that the white services were not launched as a market test, but were launched and operated simply for the purpose of driving out 2 Travel, rather than making profits for Cardiff Bus or fulfilling any other legitimate commercial strategy.

7.33 In the OFT's view, Cardiff Bus' conduct did not constitute 'normal competition on the merits', but instead was predatory and an abuse of Cardiff Bus' dominant position. Following a discussion in Section D of the rationale for Cardiff Bus' conduct, Sections E and F of this Chapter set out the OFT's assessment of the evidence, including Cardiff Bus' representations on the SO and SSO, on which the OFT has based its conclusions.

D The rationale for Cardiff Bus' conduct

7.34 As noted in Chapter 2 and in Section B of this Chapter, Cardiff Bus introduced its white services at or around the same time as 2 Travel started its no-frills services, on the same routes as those registered for 2 Travel's services, and with lower fares in three out of four zones. Cardiff Bus' withdrawal of its white services also largely coincided with 2 Travel's exit.

7.35 There are two alternative explanations for Cardiff Bus' conduct:

- The first explanation, proposed by Cardiff Bus, is that it was market-testing the no-frills concept, having been alerted to the possibility that it might be a viable business model by 2 Travel's entry.
- The second, an exclusionary rationale, is that Cardiff Bus was reacting to 2 Travel's entry by a strategy designed to force the entrant to retreat from the market.

i. Cardiff Bus' explanation for its behaviour

7.36 In its responses to the notices issued by the OFT under section 26 of the Act, as well as its written representations on the SO, Cardiff Bus claimed that it had introduced the white service in reaction to 2 Travel's introduction of its own no-frills services, with the intention of market

testing the no-frills concept. Cardiff Bus stated that:³⁹⁷ 'Cardiff Bus recognised that 2 Travel may have come up with a service for which there was customer demand, and Cardiff Bus accordingly set out to test the market itself (rather than sitting on the sidelines and giving 2 Travel a head start in the market should the 'no frills' service prove to be successful)'. LECG, in its Annexe to Cardiff Bus' written representations on the SSO also stated that:³⁹⁸ 'We understand that the standard way for Cardiff Bus to find out about the potential for a new service or route is just to try it and see, and this seems to have been 2 Travel's approach as well. This is commercially rational when there is little cost to doing so, but significant costs in terms of management time in investigating and constructing a business case, as Cardiff Bus holds is the case here'.

7.37 Cardiff Bus stated in its written representations on the SO³⁹⁹ that the routes chosen for the white services were those most likely to be profitable. Cardiff Bus also claimed that the lower prices it charged on the white services reflected the lower quality of the service.

7.38 In its representations, Cardiff Bus claimed that its decision to withdraw the white services was taken on the basis of an unexpected lack of customer demand, as well as driver shortages. In response to a section 26 notice, Cardiff Bus stated⁴⁰⁰ that: 'Whilst Cardiff Bus had always been prepared to give the no-frills services sufficient time to establish and grow patronage, it became increasingly apparent that the services were not achieving the sorts of patronage required to ensure their continuation. The services were withdrawn over time so as not to cause any significant disruption, and ultimately decisions were taken on the basis of availability of operating staff (the withdrawal of the white

³⁹⁷ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 40, paragraph 2.3(b).

³⁹⁸ See the LECG report, dated 1 August 2008, page 7. Attached as an Annexe to Cardiff Bus' written representations on the OFT's SSO. This report is referred to in this Decision as the 'LECG report'.

³⁹⁹ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007.

⁴⁰⁰ Letter to the OFT dated 15 September 2006 in response to the OFT's section 26 notice of 17 August 2006.

services coincided with a period where Cardiff Bus had significant shortage of staff overall)').

ii. **Exclusion as an alternative explanation for Cardiff Bus' behaviour**

- 7.39 The alternative explanation for Cardiff Bus' conduct is that the white services were not introduced as a market test, but as a retaliatory competitive reaction to the entry of 2 Travel, intended to divert customers from 2 Travel, even if this meant running the white services at a loss until 2 Travel exited.
- 7.40 Before considering the evidence for the possible explanations for Cardiff Bus' conduct (in Sections E and F), the OFT firstly considers what rationale Cardiff Bus might have had for adopting an exclusionary strategy.
- 7.41 As explained in Chapter 6, Cardiff Bus' ability to redeploy its fleet across its network to pre-empt new entrants, in combination with its perceived reputation among small operators for its aggressive responses, posed a strategic entry barrier for no-frills potential competitors. By predating on a no-frills entrant, Cardiff Bus could also strengthen its reputation for aggressive responses against entrants, in particular among small operators wishing to adopt a no-frills model. Moreover, the failure of the no-frills service model could send a negative signal,⁴⁰¹ deterring other potential competitors from attempting such a model in the future. Although 2 Travel's entry suggests that these strategic entry barriers at the time were not necessarily seen as insurmountable, there has been no other substantial entry in the urban market since at least 2000 (see paragraphs 6.81 onwards).

⁴⁰¹ In the related literature, one of the three main scenarios for exclusion is labelled 'signal jamming' (the others being 'reputation' and 'financial predation'), whereby a small or new competitor, having imperfect information on market profitability, is inhibited from learning the features of demand in the relevant conditions by the incumbent's predatory conduct. See: EAGCP, 2005, *An economic approach to Article 82*, Report prepared for the European Commission, Section 1, page 20, available at:

http://ec.europa.eu/comm/competition/publications/studies/eagcp_july_21_05.pdf.

- 7.42 2 Travel adopted a niche strategy by running its services only off-peak and on a few core corridors, thus targeting price-sensitive consumers and avoiding substantial confrontation with Cardiff Bus.
- 7.43 Typically, an incumbent FSO operator may be unlikely to match the prices of a small scale no-frills entrant, because it would entail cutting its prices across-the-board.⁴⁰² In this respect the incumbent may be more likely passively to accommodate small-scale entry that targets just a segment of its customer base, provided it does not feel threatened by the new entrant.⁴⁰³
- 7.44 However, such a no-frills service, whose selling point would be based on discounted single and return fares, could represent both an obstacle and a potential threat to an FSO incumbent. In particular, the presence of a no-frills operator could restrain Cardiff Bus' ability to raise its fares, given the cheaper fares such an operator could offer. This is because the no-frills discounted fares could become increasingly appealing to price-sensitive consumers facing rising normal fares. Therefore, the presence of a no-frills operator could constrain the incumbent's ability to exploit its market position.
- 7.45 Furthermore, if it were to become established, the no-frills model might offer the base from which the no-frills operator could expand⁴⁰⁴ the

⁴⁰² In this case, given the zonal structure of Cardiff Bus' single and return fares, such a price reduction could have impacted on approximately two thirds of Cardiff Bus' revenue base, despite 2 Travel only operating on four routes. According to the TAS report, adult single and return tickets account for approximately one third of Cardiff Bus' revenue base (Figure A, page 6). Moreover, as concessionary reimbursements are based on the average adult single fare – with a reimbursement rate above 70 per cent (Table 6, page 20) – the negative impact could also have been extended to this substantial revenue source, which typically accounts for about one third of the total (Figure A, page 6).

⁴⁰³ See the OFT report on switching costs (footnote 261), pages 36 to 37, paragraphs 5.11 to 5.12 of Appendix A.

⁴⁰⁴ Expansion was 2 Travel's apparent intention. See: Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004, paragraph 2.1: 'The final stage of 2 Travel's strategy is to operate full timetable commercial routes, again mainly along commercial corridors'. Also, see 2 Travel's prospectus for its 'Admission for trading on the Alternative Investment Market' (AIM), dated 14 January 2003, which states: 'The majority of the Company's bus operations link in with school bus contracts operating in the morning and the afternoon. The Board's objective is to consolidate its bus operations within the existing network of depots by adding 'infill' bus services operating throughout the day on routes

scope of its services from non-peak and certain core routes to peak hours and elsewhere.⁴⁰⁵ This could also enable a no-frills operator eventually to expand into normal services too, thus jeopardising the incumbent's frequency and network incumbency.⁴⁰⁶ It would therefore be advantageous for an FSO incumbent to pre-empt the emergence and establishment of a no-frills model.⁴⁰⁷

7.46 As noted in paragraph 7.43, an incumbent FSO operator may be unlikely to match the prices of a small scale no-frills entrant, because it would entail cutting its prices across-the-board. However, by deploying incremental and differentiated buses (the white services), Cardiff Bus could directly target the competitive threat it faced from 2 Travel without having to reduce its fares for its normal services.⁴⁰⁸

in and around the school bus runs and other peak time services currently in service. Additionally, the Board intends to expand the Company's network of operations within South Wales and into neighbouring regions'. Furthermore, on 9 March 2004, Cardiff Bus' Managing Director's report noted, under the heading 'Competition', that 2 Travel had registered to run vehicles on five of Cardiff Bus' key services from 19 April 2004, and that '...if this competition is successful there is likely to be a second tranche of registrations, which has already happened in the South West Wales area'.

⁴⁰⁵ The OFT report on switching costs noted that despite the potential lock-in effects due to frequent flyer programs, low-cost airline carriers have successfully penetrated the European market. In particular, although these carriers initially focussed on the leisure market, they have also been successful in winning business passengers away from full-service airlines (Appendix C, paragraph 1.30).

⁴⁰⁶ In the US airline industry before deregulation in the mid-1970s, (regulatory) suppression of price competition encouraged carriers to increase flight frequency and capacity to compete for passengers. The intensity of flight competition was exacerbated by the relationship between passenger share and flight share, such that a carrier with the majority of capacity on a route received a disproportionately high share of passengers (known as the 'S-curve' relationship). However, competition in flight frequency was largely a zero-sum game across carriers. See Borenstein, S. and Rose, N.L., 2007, *How Airline Markets Work...Or Do They? Regulatory Reform in the Airline Industry* NBER Working Paper No. W13452, page 10, available at: <http://www.nber.org/papers/w13452>. In the airline industry, there is evidence that the growth of low-cost carriers has disrupted the S-Curve effect. See IATA/McKinsey, 2006, *Does the S-Curve still exist?*, available at http://www.iata.org/nr/rdonlyres/f24e42b7-a8ac-4b8c-b268-4aabcf895843/0/mckinsey_scurve.pdf.

⁴⁰⁷ It might also be the case that successful penetration by no-frills operations on a wider scale could weaken an incumbent's ability to cross-subsidise across its multi-market network.

⁴⁰⁸ In contrast to the airline industry, bus operators cannot price discriminate through yield management systems. Under such systems, airlines typically price discriminate according to how much in advance a ticket is booked and/or by implementing purchase restrictions, length of stay requirements and requiring fees for changing or cancelling tickets. However, bus operators could

7.47 Exclusionary conduct⁴⁰⁹ by an incumbent operator can therefore be explained as instrumental to preserving its frequency and network incumbency, and thus ultimately insulating and strengthening its dominant position against the threat of entry by other potential FSO competitors.

E Assessment of the evidence

7.48 Section D described Cardiff Bus' explanation for its conduct and an alternative exclusionary rationale. This Section considers the evidence for these alternative explanations.

7.49 In this case, the relevant conduct of Cardiff Bus assessed by the OFT is its decision to launch (and continue operating for around 10 months) new white services which, as has already been noted, were run on the same routes as those on which 2 Travel was running, or had intended to run, its services, at prices which were lower in three out of four zones.⁴¹⁰

7.50 This Section considers the evidence in relation to Cardiff Bus' explanation for its conduct (Part i), as well as the evidence in relation to the alternative explanation that its conduct was exclusionary (Part ii). Section F then assesses the evidence on costs.

i. The evidence in relation to Cardiff Bus' explanation

7.51 As noted above, Cardiff Bus argued that its introduction of the white services was a market test for the viability of no-frills services which was unsuccessful due to unexpectedly low demand for the services, and withdrawn given driver shortages.

not implement such a system because tickets are usually purchased on-board rather than booked in advance.

⁴⁰⁹ The term 'exclusionary conduct' refers to anti-competitive conduct which harms existing or potential competition, for example by eliminating efficient competitors or raising barriers to entry and expansion. See: *Assessment of Market Power* (OFT415).

⁴¹⁰ The relevant level of output in relation to the assessment of costs is discussed further in at paragraph 7.164 onwards.

- 7.52 As contemporaneous evidence for its explanation of why it introduced the white services, Cardiff Bus provided the OFT with a press release dated 19 April 2004 which indicates that it was introducing them to establish whether there was demand for a no-frills service. The document states that: 'We do not believe that these are the future of public transport in a modern European capital city. On a commercial basis however we are bound to retest the market,⁴¹¹ to see whether a demand has emerged for this type of service. On an experimental basis we are therefore introducing a limited number of unbranded vehicles, on a no-frills basis to test demand, and will keep the situation under review'.⁴¹²
- 7.53 In an article in the Coach and Bus Weekly dated 29 July 2004, David Brown (Managing Director of Cardiff Bus) is attributed as saying: 'We don't want bus wars – effectively we're experimenting with white minibuses to see if the market is there'.⁴¹³
- 7.54 In terms of contemporaneous evidence supporting Cardiff Bus' explanation for its withdrawal of the white services, the OFT notes an internal Cardiff Bus email⁴¹⁴ from the Marketing and Communications Manager, to David Brown dated 23 December 2004, six days after 2 Travel exited, in which Mr Brown was asked to approve a draft press statement, which suggested that a lack of customer demand had led to the withdrawal. Although this press release appears not to have been published, the draft press line was closely reflected in a subsequent article in the South Wales Echo⁴¹⁵ dated 24 December 2004 in which Mr Brown was attributed as saying that: '...the public have confirmed what we already know – Cardiff needs high quality public transport operating,

⁴¹¹ Cardiff Bus explained that its reference to retesting the market related to an experiment with non-branded clipper vehicles in the early 1990s. Source: letter to the OFT, dated 15 September 2006. Cardiff Bus further stated that in the last five years, it had not operated parallel no-frills services alongside normal services, or experimented with low cost fare services, apart from the services that were the subject of this investigation. Source: letter to the OFT, dated 20 October 2006.

⁴¹² Cardiff Bus press release, 19 April 2004.

⁴¹³ Coach and Bus Weekly, 29 July 2004.

⁴¹⁴ Source: email dated 23 December 2004.

⁴¹⁵ Source: South Wales Echo, dated 24 December 2004.

early to late, seven days a week. The alternative of low quality restricted services has not proved popular in the past and customers have again voted with their feet'.

7.55 In its written representations on the SSO,⁴¹⁶ Cardiff Bus identified two other documents as contemporaneous evidence to support Cardiff Bus' explanation that the white services were a market test:

- On 16 April 2004, the Commercial Manager of Cardiff Bus wrote to the Welsh Traffic Area Office to explain that Cardiff Bus would start operating its white services from 19 April 2004. Cardiff Bus' Commercial Manager stated that Cardiff Bus was introducing these services to: '...test the commercial viability of this type of operation as a means on (sic) growing the public transport market'.
- In June 2004, the Commercial Manager of Cardiff Bus wrote an internal Cardiff Bus note⁴¹⁷ to the Managing Director, referring to a letter from the Compliance Team of the Office of the Traffic Commissioner dated 8 June 2004, '....in respect of a complaint made by the operator 2 Travel PLC concerning alleged anti-competitive behaviour they say they are experiencing on various routes in Cardiff'. In this note, the Commercial Manager stated: 'I outline below my investigation of this matter and the company's response to the points raised by 2 Travel....The main thrust of 2 Travel complaints seems to refer to the journeys operated on routes 117, 144, 150 and 162. These services were introduced from Monday 19 April, and extended from Monday 26 April, and are designed to test if the bus market in Cardiff can be further grown by the introduction of a "no frills" type of operation with routes operating at a lower frequency, using older vehicles and at lower fares than the corresponding high frequency routes'.

⁴¹⁶ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraphs 6.7 to 6.10.

⁴¹⁷ This memo is dated 17 April 2004, but in its written representations on the OFT's SSO, dated 1 August 2008, Cardiff Bus stated that it considered that it was likely to have been produced in June 2004.

7.56 The OFT has carefully considered Cardiff Bus' explanation for its introduction of the white service. While the OFT accepts that it is likely that Cardiff Bus perceived 2 Travel's entry as a credible competitive development, the OFT does not consider there is convincing evidence to support Cardiff Bus explanation that its white services were introduced as a 'market test'.

7.57 In particular, the OFT considers the following points in turn below:

(a) Little contemporaneous or internal evidence to support Cardiff Bus' explanation, and

(b) Evidence contrary to Cardiff Bus' explanation.

(a) Little contemporaneous or internal evidence to support Cardiff Bus' explanation

7.58 Cardiff Bus' letter to the Welsh Traffic Area Office (discussed in paragraph 7.55), as well as its draft and actual statements to the press and related press articles are evidence of its external and public explanation at the time for introducing the white services. The internal note from Cardiff Bus' Commercial Manager to the Managing Director (discussed in paragraph 7.55) also states that the white services were to 'test' the market, but the OFT notes that this note was written two months' after the white services started, following complaints by 2 Travel to the Traffic Commissioner that Cardiff Bus was acting anti-competitively, and that the note was prepared in order to inform the '...company's response to the points raised by 2 Travel'.⁴¹⁸

7.59 These examples aside, the OFT has no other contemporaneous evidence to support Cardiff Bus' explanation that the white services were a market test.

7.60 The OFT would expect Cardiff Bus to be able to produce direct evidence of contemporaneous internal documents relating to its plans to run such a test – for example, some evidence of internal consideration of issues

⁴¹⁸ Ibid.

such as the most appropriate choice of routes, timings and fares for an experiment, or how such a test's effectiveness would be assessed. The OFT would also have expected there to have been at least some evidence that the results of the test had been analysed and discussed, as well as some evidence of when, how and why decisions had been taken to end the market test.

7.61 Cardiff Bus has failed to provide any such contemporaneous evidence and stated⁴¹⁹ that it did not have, and did not produce, any documents relating to the market testing or withdrawal of the white services. It contended that this was because Cardiff Bus is a '...small company where communication tends to be direct rather than by email or memo'.⁴²⁰

7.62 Cardiff Bus suggested in its written representations on the SO⁴²¹ that: '...without evidential support for its assertions, the OFT cannot justifiably do other than rely on the evidence that actually exists – that is, the clear public statements that Cardiff Bus was testing demand'. Cardiff Bus argued⁴²² that the OFT could not draw inferences from a lack of detailed internal documents without establishing whether '...equivalent documents are routinely produced by Cardiff Bus in respect of equivalent experiments'.

7.63 In addition, Cardiff Bus argued⁴²³ that because 2 Travel did not provide the OFT with a business plan, it is unreasonable for the OFT to expect Cardiff Bus to provide further proof of its plans for the white service: 'As the Cardiff Bus white services and 2 Travel services were new, there was clearly an element of uncertainty as to the level of demand for no-frills bus services. However, it is clear that at the time of their introduction 2 Travel was very confident that there would probably be demand for these services. In light of 2 Travel's apparent confidence,

⁴¹⁹ Letter to the OFT dated 14 September 2005; and letter to the OFT dated 15 September 2006.

⁴²⁰ Letter to the OFT dated 14 September 2005, paragraph 1.6.

⁴²¹ Cardiff Bus' written representations on the OFT's SO dated 7 August 2007.

⁴²² Ibid.

⁴²³ Ibid.

Cardiff Bus felt bound to retest the market. The result was that neither produced specific business plans for the services'.

7.64 In its written representations on the SSO,⁴²⁴ Cardiff Bus stated that the white services constituted only [...] [C] per cent of total mileage, [...] [C] per cent of total peak vehicle requirement and [...] [C] per cent of Cardiff Bus' total costs in the period 2004/05. Cardiff Bus commented that: 'In the light of this the OFT's expectation of seeing extensive management time expended on what was a tiny proportion of Cardiff Bus' operations is misplaced. In addition and as already pointed out, the very purpose and nature of the service provided was budget. It would have been antithetical to the nature of the white services for Cardiff Bus to have inflated the costs of such an operation by carrying out extensive market testing to assess its viability'.

7.65 The OFT does not accept these arguments. The OFT would expect that, in an organisation such as Cardiff Bus, a market test that had the potential to give rise to significant losses would be preceded by considerable forethought, such as documents recording the preparation of a business case that was signed off at a senior level. The OFT would also expect a market test to generate some contemporaneous evidence of assessment of whether or not it was proving to be successful.⁴²⁵ The OFT would also expect there to be some contemporaneous evidence to explain the internal thinking and assessment underlying the decision to end such a test. Finally, if the white services had been a market test, the OFT would expect Cardiff Bus to be able to present data it had gathered and analysis of the reasons why potential passengers had chosen not to use the buses, to demonstrate what it had learnt from the

⁴²⁴ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraphs 6.4 to 6.6.

⁴²⁵ Cardiff Bus provided the OFT with record sheets of observations ('Competitive Services Logs') by its staff of times and apparent passenger numbers on the white services and 2 Travel's services. These are discussed further later in this Section. However, Cardiff Bus has not supplied any evidence of analysis or profitability assessment of its white services. Indeed, the OFT notes that, in a response dated 14 September 2005 to a section 26 notice, concerning the record sheets for the 'loadings observations', Cardiff Bus stated: '...there are no electronic versions of these and the data from them was never analysed in detail'.

'experiment'. Cardiff Bus has not been able to provide any documents of this kind.

- 7.66 In relation to Cardiff Bus' argument that expending resources on analysis would be antithetical to the nature of the services, the OFT observes, as described in paragraphs 7.131 to 7.136, that Cardiff Bus did devote time and resources to gathering data while it was running its white services as well as to discussing developments, but the evidence shows that the focus of this attention was not on whether the white services were successful as a new service for customers, but on the progress and strength of 2 Travel as a competitor.
- 7.67 In relation to whether the OFT can draw inferences without establishing whether '...equivalent documents are routinely produced by Cardiff Bus in respect of equivalent experiments',⁴²⁶ the OFT notes that Cardiff Bus stated⁴²⁷ that it had not conducted a 'no-frills experiment' for at least the last five years. Nevertheless, and as noted in Chapters 4 and 6, Cardiff Bus has in the last five years commissioned consultants such as TAS and Deloitte to conduct internal reviews, as well as commissioning market research by, for instance, Market Research UK and Cardiff Research Centre.
- 7.68 In particular, the OFT notes that Cardiff Bus was conducting market research during the period the white services were running. In November 2004, Adsearch Ltd conducted⁴²⁸ eleven two-hour focus groups with bus users and potential bus users (each group comprising eight or nine respondents). Also in November 2004, Market Research UK Ltd presented Cardiff Bus with the findings from a survey of 1,000 people interviewed on buses and at bus stops between 11 October and 14 November 2004; as well as 200 potential users interviewed in Cardiff

⁴²⁶ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007.

⁴²⁷ Source: letter to the OFT dated 20 October 2006.

⁴²⁸ *What do Cardiff Bus Customers Look for in a Bus?*, presentation prepared for Cardiff Bus by Adsearch Limited, November 2004.

between 3 and 9 November 2004; and two focus groups conducted on 25 and 26 November 2004.⁴²⁹

- 7.69 Given that this consumer research coincided with the operation of the white services, which Cardiff Bus said was an experiment, the OFT notes that Cardiff Bus does not appear to have used this opportunity also to seek specific views on whether and why users might travel on no-frills bus services.
- 7.70 In its written representations on the SSO,⁴³⁰ Cardiff Bus stated that these examples of research were: '...general items of research which do not cover customer research on specific routes or services. The survey and findings of both items of research cited are very general in nature and were intended to give Cardiff Bus general feedback on customers and their preferences. They are as applicable to the white services as to the numerous other bus services run by Cardiff Bus in Cardiff. There is therefore no basis for the OFT to use the lack of specific market research questions on white services as evidence that the operation of these services was not a genuine market testing exercise by Cardiff Bus'.
- 7.71 However, given the timing of the surveys, the OFT notes that Cardiff Bus does not appear to have used these concurrent research exercises to help it to understand why its no-frills services were not proving popular, so that it could make an informed decision on whether to continue with them, or to make adjustments to them. The OFT notes that Cardiff Bus spent considerable resources on running its white services for ten months, which it claims was to market test consumers' interest in such services, and could have asked some specific questions about such services at little or no additional cost to its existing research, but did not do so.

⁴²⁹ *Cardiff Bus Customer Profiling (Current and Potential Customers)*, November 2004 prepared by Market Research UK Ltd.

⁴³⁰ Cardiff Bus' written representations on the OFT's SSO, 1 August 2008. Page 31, paragraph 6.11.

7.72 In Cardiff Bus' case, the white services were a significant departure from its normal business model and required the preparation and use of different buses. In these circumstances, the OFT considers it reasonable to expect evidence of some planning, which would also form the basis of a market test to enable effectiveness to be measured and assessed. This is different from the position of 2 Travel. Although 2 Travel did not produce a business plan,⁴³¹ its no-frills services were part of its normal business strategy and represented only an additional use of buses it was already running for tendered services.

7.73 Given that Cardiff Bus expended resources on monitoring⁴³² and on conducting research, and that it clearly considered no-frills to be a significant (and a questionable) departure from its business model, the OFT considers the absence of contemporaneous internal evidence to demonstrate that the white services were launched and operated for the purposes of market testing, to be significant.

7.74 In the light of the absence of contemporaneous evidence to support Cardiff Bus' public statements that the introduction of the white services was a market test, the OFT now turns to consider evidence that conflicts with Cardiff Bus' claims.

(b) Evidence contrary to Cardiff Bus' explanation

7.75 While there is little contemporaneous evidence to support Cardiff Bus' explanation for the white services, there is evidence that does not support, but instead conflicts with, Cardiff Bus' suggestion that it was conducting a market test. In particular, the OFT discusses below the following evidence that:

- (i) Cardiff Bus publicly disparaged the concept of no-frills services, and
- (ii) Cardiff Bus actively avoided promoting its new services.

⁴³¹ Agreed note of meeting on 10 August 2006, paragraph 25.

⁴³² See the discussion at paragraph 7.134 to 7.136.

(i) Cardiff Bus publicly disparaged the concept of no-frills services

7.76 The OFT notes Cardiff Bus' claim in its written representations on the SO⁴³³ that there was some press coverage at the time for the white services. If as Cardiff Bus asserts, it was market testing the white services, the OFT would expect Cardiff Bus to have been positive (or at least neutral) in its press notices about the concept of no-frills services, so as not to undermine its own experiment. However, Cardiff Bus' press releases were, in fact, disparaging about the value of no-frills services.

7.77 For example, its press release of 13 April 2004 is titled 'Nothing new offered by limited competitive services'.⁴³⁴ This press notice referred to 2 Travel's no-frills services and stated: '2 Travel will give nothing new to the citizens of Cardiff or the operation of the public transport network'. In its written representations on the SSO,⁴³⁵ Cardiff Bus stated that this press release had criticised 2 Travel's bus service, rather than the no-frills bus concept as a whole. However, the OFT notes that this press release also described in a negative tone the nature of 2 Travel's planned no-frills services, which Cardiff Bus then effectively mirrored.

7.78 In its written representations on the SSO, Cardiff Bus also stated⁴³⁶ that in a press article dated 20 April 2004 David Brown had stated that Cardiff Bus was: '...bound to retest the market, to see whether demand has emerged for this type of service. It could be that there is room for an Aldi as well as a Lidl-type service'. However, the OFT notes that the Cardiff Bus press release of 19 April 2004, titled 'Business As Usual', on which much of this article was apparently based, was clearly downbeat about no-frills services, stating: 'We note that 2 Travel believes that there is a market for what can perhaps best be described as a "no frills" operation – limited frequency, older vehicles, basic

⁴³³ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, paragraph 2.23 on page 46.

⁴³⁴ Cardiff Bus press release dated 13th April 2004.

⁴³⁵ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraphs 6.14 to 6.16.

⁴³⁶ Ibid.

standards and lower fares. Experience in the past has indicated that such services are generally unsustainable in the longer term, even when cherry picking key routes and times of day. We do not believe that these are the future of public transport in a modern European capital city...Those vehicles [the white service buses] are independent of our core business which will remain unchanged...we have no desire to change what has proven to be a winning formula'.

7.79 These downbeat public messages are not consistent with the positive mood the OFT would ordinarily expect an undertaking to want to generate when announcing that it was testing a product. The OFT concludes that these press releases further undermine Cardiff Bus' assertions that it was experimenting with the white services. Moreover, the OFT notes that the focus of Cardiff Bus' press statements was on 2 Travel and how Cardiff Bus was reacting, further suggesting that the introduction of the white services was not a market test, but directed simply at excluding 2 Travel.

(ii) Cardiff Bus actively avoided promoting its new services

7.80 In addition, Cardiff Bus was reluctant to attract publicity for its white services, which is contrary to what the OFT would expect to see if, as Cardiff Bus contends, it was market testing its new no-frills service.

7.81 In its written representations on the SSO,⁴³⁷ Cardiff Bus stated: 'In launching other services we have not promoted services, the key marketing is for buses 101 and 102'. However, the OFT notes that in September 2003, Cardiff Bus launched its new L8 night bus service with a positive press release containing timetable information, and with associated marketing. Promoting the service, a Cardiff Bus press release stated:⁴³⁸ 'Passengers are being urged to 'stay for a L8 one' in a

⁴³⁷ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraphs 6.18 to 6.20.

⁴³⁸ Cardiff Bus press release 'L8 BUS HOME - SAFE TRAVEL FOR CARDIFF NIGHT OWLS', dated 26 September 2003. At:

<http://web.archive.org/web/20040606185554/www.cardiffbus.com/news/press/030917.htm>.

marketing campaign...'. A subsequent BBC website article⁴³⁹ a week after its launch reported that: 'Organisers of a new late bus service for Saturday night clubbers in Cardiff say it has got off to a flying start...', and quoted a Cardiff Bus spokesperson as saying: 'Last weekend was very encouraging for us...Things ran very smoothly and we are not planning to make any changes to this weekend's service'.

7.82 The OFT notes that, in contrast to its release for the L8 night bus, Cardiff Bus' press releases for its white services did not include any practical information on their routes or the times, as might have been expected when launching a new service. In this respect, the OFT also notes that Cardiff Bus' internal guidelines⁴⁴⁰ for the white services stated: 'No timetables will be produced for competitive services, nor will details of these services be added to roadside timetables, PTI Cymru database or Real Time information system'. The OFT further notes a contemporaneous press report⁴⁴¹ which suggested that Cardiff Bus was making little effort to give potential customers practical information on the white services, stating: 'Cardiff Bus also says timetables are available from its West Street office but, when CBW called Traveline Cymru, the operator was unable to find times for 117, 150 and 162 services'.

7.83 The company's reluctance for publicity is evidenced by an email from the Managing Director to [....][C] dated 16 April 2004 stating that: '...the view here is that we simply cannot ignore [....][C] and it is better to keep in control of things. Inevitably [....][C] ask for details of how many vehicles and the fares charged – I think I will have no choice other than to tell [....][C] will be able to work out the details [....][C] if we do not supply the information. PLEASE NOTE THAT ALL COMPETITION PRESS RELEASES ARE FOR [....][C] ONLY AND SHOULD NOT BE

⁴³⁹ See 'Saturday night flier for L8 buses. Article on BBC News website on 3 October 2003. At: http://news.bbc.co.uk/1/hi/wales/south_east/3158452.stm.

⁴⁴⁰ Competitive services guidelines provided by Cardiff Bus to the OFT in response to a section 26 notice dated 26 May 2005.

⁴⁴¹ 'Cardiff Bus refutes driver tactics claim' – article in Coach and Bus Weekly, dated 12 August 2004.

CIRCULATED ANY FURTHER. If other media pick up on the story then we will deal with that on a case by case basis'.

- 7.84 Cardiff Bus argued in its written representations on the SO⁴⁴² that it '...did not want to attract too much publicity to its 'no frills' services for fear of also giving free publicity to 2 Travel's services'. Cardiff Bus also argued⁴⁴³ that 2 Travel did not advertise its own services and that Cardiff Bus '...did not want to send out mixed public messages: on the one hand promoting its high quality services and on the other a handful of new experimental no frills services'.
- 7.85 The OFT acknowledges that Cardiff Bus may not have wanted to draw attention to a competitor's service, but concludes that its avoidance of publicity and lack of promotional activity or of effort to give potential customers practical information, as well as the focus of the available evidence on 'competition', is sufficient to demonstrate that the introduction of the white service was to address 2 Travel's entry and not to test out public demand for no-frills services.

ii. Evidence supporting exclusion as an alternative explanation

- 7.86 As noted above, there is little contemporaneous evidence to support Cardiff Bus' explanation, and moreover there is evidence that is contrary to it. In addition, the following evidence supports the alternative explanation that Cardiff Bus' conduct was exclusionary:⁴⁴⁴

⁴⁴² Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007.

⁴⁴³ Ibid.

⁴⁴⁴ In its complaint in November 2004 (Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT, 3 November 2004), 2 Travel claimed that Cardiff Bus had been running its no-frills services a few minutes before 2 Travel's services in order to minimise 2 Travel's passenger numbers, and that Cardiff Bus drivers were intimidating 2 Travel drivers. In respect of 2 Travel's claims that the white services were run just before 2 Travel's no-frills services, the OFT notes that Cardiff Bus Competition Policy document (see paragraphs 7.89 onwards for a discussion of this document) contained the following proposal: '...Buses will be timed to operate just in front of the competitor's vehicles. Where the competitor departs from the scheduled time our times will vary to remain in front of the competitors vehicles'. However, the OFT does not have any convincing evidence on this issue. Nor did the OFT consider 2 Travel's claims of intimidation. The OFT notes that such allegations fall to the Traffic Commissioner to consider. In this regard, the Traffic Commissioner's

- (a) evidence of Cardiff Bus' pre-planning and preparations,
- (b) the coincidence of routes and timing,
- (c) the costless transferability of the white services' tickets,
- (d) evidence that the impact on 2 Travel was Cardiff Bus' key success measure, and
- (e) evidence that the withdrawal of white services was triggered by 2 Travel's exit.

7.87 Moreover, in Section F, the OFT sets out its evidence that the white services failed to cover their costs.

(a) Evidence of Cardiff Bus' pre-planning and preparations

7.88 There is clear evidence that Cardiff Bus planned a competitive response once it became aware of 2 Travel's likely entry and made early preparations to introduce the white services.

(i) Evidence of pre-planning

7.89 In response to the OFT's section 26 notice dated 26 May 2005, Cardiff Bus supplied an internal document titled 'Competition policy' (referred to in this Decision as the 'Competition Policy document') dated 24 March 2004. This document states that it: '...sets out the rules to be followed in the competitive environment, which will emerge, from mid April'. This

representative] held an informal meeting on 22 November 2004 with both parties which included a discussion about 2 Travel's claims that Cardiff Bus' drivers had harassed 2 Travel's drivers. Having assessed the evidence, the Traffic Commissioner['s representative] stated in a report summarising the meeting: 'I do not believe that senior members of Cardiff Bus have issued instructions inciting their drivers to act in an unsafe manner. I do not dismiss the possibility that supervisors in the depots may have aggravated the situation and helped to incite the drivers but there is no clear evidence of this'. The Traffic Commissioner['s representative] concluded: 'That no action be taken against Cardiff Bus as there is no evidence that they have a case to answer'. See: Report of meeting held between 2 Travel Group plc and Cardiff City Transport Services Ltd on 22 November 2004, paragraph 42. [The proposed actions in the report were subsequently agreed by the Traffic Commissioner.] Note: the text in square brackets was added to this footnote after the Decision was issued, following comments on the footnote in a letter from the Office of the Traffic Commissioner dated 25 November 2008.

document proposed that Cardiff Bus' response should be to: '...operate an experimental low grade service', using buses in a white livery differentiated from the 'mainstream high quality low floor Cardiff Bus operation', with fares below normal services. The document stated: '...Inspectors and drivers must follow the principle that our services should operate within the legislative framework and safely at all times but effectively reducing the opposition's carryings to the absolute minimum'.

7.90 Although the Competition Policy document did not specifically refer to 2 Travel, the OFT considers that it was clearly aimed at targeting 2 Travel's new commercial bus services, which began operating on 19 April 2004 (less than one month after the date of the Competition Policy document), and that references in the document to 'the competitor', 'the opposition' and 'the incoming operator' are in fact references to 2 Travel. In addition to the timing of the plan, this conclusion is further supported by the proposed approach to introduce a no-frills service, which is what Cardiff Bus subsequently did.

7.91 Cardiff Bus stated⁴⁴⁵ that its Competition Policy document dated 24 March 2004 was 'never implemented'. Similarly, in its written representations on the SO, Cardiff Bus stated:⁴⁴⁶ 'The OFT places strong reliance on its interpretation of the 'competition policy' document. This document was produced by Cardiff Bus' previous management, prior to the introduction of the white services. It was never used as a policy document during the operation of the white services. There is clear evidence of this in the fact that, for example, the regular 'competition meetings' proposed in that document did not take place. This has previously been made clear to the OFT. However, the OFT still attempts to rely on the document'.

7.92 At the oral representations hearing, Cardiff Bus referred to the Competition Policy document and its Managing Director David Brown

⁴⁴⁵ Response of 15 September 2006 to the OFT's section 26 notice dated 17 August 2006.

⁴⁴⁶ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007.

stated:⁴⁴⁷ 'I couldn't even remember that there was a competition policy document. I mean that was the extent of it, it was something that had been produced by my predecessor and was just ditched, you know, it just – it was a non-event. But I think that is where we have some difficulties in a way, in that clearly, you know, I understand the legal and economic focus that you all have. The reality is this is a small company. We're running a business and the importance that you attach to some things just, you know, they were just things – ships that passed in the night. And that particular document, as I said, was one from my predecessor. When I was reminded of it I did remember what it was, but I've made no use of it, no further reference to it. That was my predecessor's document. But clearly it exists, and he had something in his mind when he wrote it, but it wasn't the way I took things forward'.

7.93 The OFT notes Cardiff Bus' assertion that the Competition Policy document was not implemented, that it does not represent the way Mr Brown 'took things forward' and that it was his predecessor's document. However, the OFT also notes the following:

- (a) Prior to becoming the Managing Director of Cardiff Bus in April 2004, Mr Brown had been Cardiff Bus' Finance Director and Company Secretary for a period of ten years,⁴⁴⁸ and was in place throughout the period covering the Competition Policy document's production and the subsequent operation of the white services.
- (b) Minutes of meetings provided by Cardiff Bus⁴⁴⁹ show that prior to becoming Managing Director, Mr Brown attended several Board

⁴⁴⁷ Agreed transcript of oral representations hearing on 15 October 2007, page 22 line 1.

⁴⁴⁸ Cardiff Bus press release 'New MD for Cardiff Bus', dated 8 April 2004, which states:

'...Cardiff Bus has announced that its new Managing Director is to be David Brown subject to the formal approval of the County Council. 48 year old Mr Brown of Cardiff has been the Finance Director and Company Secretary of Cardiff Bus for the past 10 years and succeeds Alan Kreppel who leaves the company at the end of May'. Available at:

<http://web.archive.org/web/20040606211020/www.cardiffbus.com/news/press/040408.htm>.

See also e-mail from David Brown to Thomas Knowles, dated 25 June 2004, in which Mr Brown states that: '...I took over from AK formally on 1 April'.

⁴⁴⁹ Minutes of Board meetings dated 9 September 2003, 11 November 2003, 3 January 2004 and 9 March 2004.

meetings at which Cardiff Bus' response to 2 Travel was discussed.

- (c) Other members of Cardiff Bus' Management Team, such as its Commercial Manager (who is named in the Competition Policy document) were in place before, during and after the development of the Competition Policy document. There were also members of the Board in place throughout this period - for instance, [...] [C] attended all the Board meetings in the period 9 September 2003 to 30 November 2004.
- (d) As noted in paragraph 7.92, Mr Brown named his predecessor, Mr Kreppel, as the person responsible for developing the Competition Policy document, but also stated that:⁴⁵⁰ '...it was something that had been produced by my predecessor and was just ditched'. However, the OFT also notes that Mr Kreppel attended the May 2004 Board meeting as 'Managing Director' (with Mr Brown attending as 'Managing Director Designate'), two weeks after the first white services had started.
- (e) As set out at Table 23, there is substantial similarity between Cardiff Bus' proposed actions in the Competition Policy document and its actual actions carried out while Mr Brown was Managing Director. This is to the extent that of the 16 key actions proposed by Cardiff Bus in its Competition Policy document, at least 10 were partly or fully implemented by the company in the following weeks.

7.94 Accordingly, whether or not the Competition Policy document was formally adopted by Cardiff Bus' Board of Directors, that document was plainly prepared at the senior executive level within the company and, in the OFT's view, is demonstrative of exclusionary intent. Further, the fact that Cardiff Bus' conduct on the market closely resembled that proposed in the document strongly suggests that the policy was substantially implemented and that the intent behind that conduct was itself exclusionary.

⁴⁵⁰ Agreed transcript of oral representations hearing on 15 October 2007, page 22 line 1.

Table 23: Summary of actions proposed in the Competition Policy document and Cardiff Bus' actual actions

Proposed action in Competition Policy document in response to an 'incoming operator'	Actual action by Cardiff Bus
1. On the company's services registered as frequent the company will operate an experimental low grade service with additional mileage to match the mileage of the competitor.	1. Cardiff Bus introduced a low grade service on the same routes (with the same frequency as 2 Travel) where 2 Travel introduced its new commercial services.
2. Buses will be in a white livery	2. Cardiff Bus' white services had a white livery.
3. Buses will be timed to operate just in front of the competitor's vehicles. Where the competitor departs from the scheduled time our times will vary to remain in front of the competitors vehicles.	3. The OFT has insufficient evidence of this. This was a matter for the Traffic Commissioner. The Traffic Commissioner found ⁴⁵¹ that Cardiff Bus' drivers were told to operate at half hourly frequencies but that they should use their common sense and spread out if congestion led to bunching.
4. Where the competitor fails to appear or disappears for a meal break we will run the mileage until the two vehicles can be "re engaged".	4. Insufficient evidence provided.
5. Drivers will to all intents and purposes be in civilian clothing and ticket machine rolls will be white. This is to differentiate the vehicle and the product completely from the mainstream high quality low floor Cardiff Bus operation.	5. Cardiff Bus' drivers on the white services wore their own coat, jacket, fleece or jumper. Tickets issued on the white services were white.
6. Fares charged will be similar or the same as competitor's fares. At the start of the operation the adult single fares are likely to be as follows with appropriate day returns and child fares:- <ul style="list-style-type: none"> • Zone 1/2 - 60p • Zone 3 - 80p • Zone 4 - £1 	6. Cardiff Bus charged exactly the same fares for its white services as set out in its competition policy document: ⁴⁵² <ul style="list-style-type: none"> • Zone 1/2 - 60p • Zone 3 - 80p • Zone 4 - £1
7. The company's multiride, returns, local rider, network rider and all other company day or season tickets will be accepted on the separate "white bus" operation.	7. Cardiff Bus' multiride, returns, local rider, network rider and all other Cardiff Bus day or season tickets were accepted on the white services.
8. Where the competitor changes fares, such that they are below our experimental operations we will match their fare scale, but will not charge below the fare scale. The principle to be followed is that we will 'not be knowingly undersold.'	8. 2 Travel did not change its fares. Rather than matching 2 Travel's no-frills fares, Cardiff Bus' white service fares were priced below 2 Travel's fares on three out of four zones (see paragraph 2.52).

⁴⁵¹ Report of meeting prepared by the Traffic Commissioner's Office, following a meeting on 22 November 2004 with Cardiff Bus and 2 Travel.

⁴⁵² As noted in Section F, Cardiff Bus has not provided an explanation for how these fares were calculated. The OFT also notes that Cardiff Bus' internal guidelines for the white services stated in relation to the white service fares that 'These fares will be altered once 2 Travel fares are known'. Source: Competitive services guidelines provided by Cardiff Bus to the OFT in response to a section 26 notice dated 26 May 2005.

<p>9. In terms of publicity we will keep all publicity to an absolute minimum, we do not want to have comments from managers causing “eye grabbing” headlines. We need to reduce the publicity opportunities for the opposition as much as possible.</p>	<p>9. The available evidence indicates that Cardiff Bus kept publicity for the white services to a minimum.</p>
<p>10. The team operating the white vehicles will require instant communication between the team, with supervisors and with the Control Room. This may require a separate radio system. [...] [C] please progress.</p>	<p>10. White service drivers had direct radio contact with the competitive services supervisor.</p>
<p>11. Supervision of the operation needs to be down to one key Inspector with a fully trained stand-in. Inspectors and drivers must follow the principle that our services should operate within the legislative framework and safely at all times but effectively reducing the opposition's carryings to the absolute minimum.</p>	<p>11. Cardiff Bus' 'Competitive Services – Drivers Notes' states: 'The competitive services will be monitored and controlled by a dedicated supervisor (normally [...] [C]) during the period of operation.'⁴⁵³</p>
<p>12. The Supervisory staff should build a good rapport not only with their own staff, but with the opposition's drivers who may be persuaded to join and work for us as the incumbent operator rather than the new competitor.</p>	<p>12. 2 Travel claimed that Cardiff Bus' drivers harassed its drivers. However the OFT does not have sufficient evidence on this (although this issue was considered by the Traffic Commissioner - see footnote 444).</p>
<p>13. In terms of our mainstream operations there must be no lost mileage on services which are subject to competition. Bus Station and control inspectors must pay particular attention to ensure that there are no operational gaps in any of these services. If need be vehicles will be switched from other areas to ensure that no holes appear for the opposition to fill.</p>	<p>13. Cardiff Bus maintained the frequency of its normal services during the period that it operated its white services.</p>

⁴⁵³ Competitive services guidelines provided by Cardiff Bus to the OFT in response to a section 26 notice dated 26 May 2005.

<p>14. During the first week of operation we will not be registered to operate certain outlying sections of service covered by the competition. Our operation will start at exactly the same time and date as the incoming operator. Initially we will have to terminate short on some operations in the first week (e.g. Carpenters Arms) as our registrations do not become live for some of the outer sections until the following week.</p>	<p>14. During the first week of operation Cardiff Bus were not registered to operate certain outlying sections of service covered by 2 Travel.⁴⁵⁴ Cardiff Bus started to introduce its white services at exactly the same time and date as 2 Travel, with service 117 starting on 19 April 2004 and the remaining white services starting on 26 April 2004.</p>
<p>15. The duty supervisor of the competitive operation will need to ensure that full details are taken of both our and other company's loadings. We will also need...a programme of obtaining loadings from other sources and geographical points so that we can establish exactly the market penetration of the competition and the estimated number of passengers being carried per week. [...][C] to pursue.</p>	<p>15. Cardiff Bus prepared detailed loadings data for both the white services and 2 Travel's services covering the period April 2004 to December 2004. See paragraph 7.134 onwards for further discussion.</p>
<p>16. Every week [...][C] should chair a competition meeting involving drivers, supervisory staff and marketing to review the competitive position, making any adjustments to our operation and strategy as required to minimise the competitors' passenger carryings.</p>	<p>16. Cardiff Bus has stated that meetings did take place concerning the setting up of Cardiff Bus' no-frills services, but the meetings were operational in nature and ceased after the introduction of the white services. At the oral representations hearing Cardiff Bus clarified this point:⁴⁵⁵ '...there were meetings, but that's different from the – I can't remember what the details of the competition meetings – described as competition policy documents either weekly or fortnightly or whatever they were, clearly didn't take place. But there were obviously meetings about 2 Travel'.</p>

7.95 In its written representations on the SSO,⁴⁵⁶ Cardiff Bus commented in relation to the Competition Policy document: '...it is not clear that the Competition Policy was in fact implemented. The OFT has not put forward evidence that all aspects of it were implemented. The OFT has

⁴⁵⁴ In its response to the OFT's section 26 notice on 11 July 2005, Cardiff Bus provided the OFT with its Schedule of White Bus services. This Schedule indicated that the date of commencement of the 117 service was 19 April 2004, with services 144, 150, 157/158 and 162 starting on 26 April 2004. According to Cardiff Bus, services 117, 144, 150 and 162 were '...covered entirely or in part by what are termed "frequent service" registrations' (see Cardiff Bus Frequent Service Registrations, provided by Cardiff Bus to the OFT on 11 July 2005). For white services 117 and 144, the whole route was covered by the registration, but for white services 150, 157/158 and 162, Cardiff Bus registered parts of the routes with the Traffic Commissioner to run from 26 April 2004. See also footnote 45.

⁴⁵⁵ Agreed transcript of Cardiff Bus oral representations hearing on 15 October 2007.

⁴⁵⁶ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 6.29.

not sought to, and is not entitled to, infer from partial implementation that the Competition Policy was wholly implemented'.

- 7.96 The OFT rejects this argument. The title of the document and, in combination, the actions described in it, make clear that the intention was to target 2 Travel. There is no need for the OFT to demonstrate that every element was implemented but it is, in any case, clear that most were. This evidence, taken in the round with the other evidence considered in this Decision is sufficiently convincing for the OFT to conclude that the Competition Policy document was demonstrative of exclusionary intent.
- 7.97 The OFT also notes an internal document prepared by Cardiff Bus' Commercial Manager titled 'Cardiff Bus Traffic Notice 2 Travel services' dated 14 April 2004. This sets out Cardiff Bus' response to 2 Travel, but makes no mention of market testing.⁴⁵⁷
- 7.98 This evidence conflicts with Cardiff Bus' explanation that it had introduced the white services as a market test. Instead, it supports the view that the purpose of the white services was as a competitive retaliatory response. The OFT also notes that these documents represent the only contemporaneous internal evidence presented by Cardiff Bus of its plans for the white services. In addition, they show that substantial effort was made by Cardiff Bus to prepare to run its white services, which is in contrast to the lack of any evidence that Cardiff Bus subsequently assessed whether and why the services had been a success or failure.
- (ii) Evidence of preparations
- 7.99 As noted in footnote 37, Cardiff Bus Board minutes from 11 November 2003 state that: 'A number of actions were being taken to address the

⁴⁵⁷ Cardiff bus traffic notice, dated 14 April 2004.

potential for a competitive attack in the run up to Christmas including the retention of surplus vehicles'.⁴⁵⁸

- 7.100 In addition, the OFT notes that Cardiff Bus registered all of its key corridor routes as 'frequent routes' with the Traffic Commissioner on 3 November 2003. Cardiff Bus' Managing Director's report of 11 November 2003 stated, under an Agenda item titled 'Competition', that this enabled: '...extra services to be run between those currently operating, on the main corridors' without further registrations being made to the Traffic Commissioner.⁴⁵⁹
- 7.101 While it may be argued that registering these routes as frequent could also support Cardiff Bus' explanation that it was preparing to run a market test, the OFT notes that 'Competition' was the title of the Agenda item under which the Managing Director explained the developments to Cardiff Bus' Board. The OFT considers that its actions assisted Cardiff Bus' plans to react to competition by enabling it to engage in an immediate and aggressive response to any competition that it envisaged 2 Travel might introduce in the market. In particular, the OFT notes that Cardiff Bus registered all of its key corridors as frequent, whereas it need only have registered those corridors on which it would have run a test had that been its intention. Cardiff Bus' actions were therefore consistent with it preparing its reaction to entry, where it could not at that stage be certain on which routes it would be facing competition.
- 7.102 Furthermore, in response to a section 26 notice, Cardiff Bus supplied⁴⁶⁰ the OFT with a Staff Notice, dated 4 March 2004, encouraging its employees to apply by 19 March 2004: '...for a driving role protecting your Company's status, reputation and profitability...on routes shortly to be facing competition' (see Figure 23). This staff notice makes no mention of needing the drivers for an experiment or test. Instead, it is

⁴⁵⁸ Minutes of Cardiff Bus Board meeting dated 11 November 2003.

⁴⁵⁹ See Cardiff Bus' schedule of normal livery services and Managing Director's report, 11 November 2003.

⁴⁶⁰ Provided by Cardiff Bus on 11 July 2005, in response to the OFT's section 26 notice dated 26 May 2005.

clear that the drivers were to be used to protect Cardiff Bus against competition. In particular, the OFT also notes that interested staff were to apply to '[...][C], Assistant Operations Manager, Ws20 (Battlebus)'. The OFT considers that the use of the term 'Battlebus' is further indication of the true intent of Cardiff Bus when setting up its white services.

Figure 23: Cardiff Bus Staff Notice recruiting drivers for the white services

Cardiff Bus
BWS CAERDYDD

STAFF NOTICE

WANTED

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PROFESSIONAL
COMMITTED
FLEXIBLE
RELIABLE
COMPANY MINDED

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A
F

YOUR COMPANY NEEDS
YOU

If you wish to be considered for a driving role protecting your Company's status, reputation and profitability, in a highly professional manner, on routes shortly to be facing competition, please apply in writing to [...][C], Assistant Operations Manager by Friday 19th March 2004.

[...][C]
ASSISTANT OPERATIONS MANAGER
Ws20 (BATTLEBUS)
04.03.04

(b) **The coincidence of routes and timing**

7.103 As noted in Chapter 2 and Section B of this Chapter, Cardiff Bus introduced the white services to coincide with 2 Travel's entry to the market and to cover the same routes as those registered for 2 Travel's no-frills services. Cardiff Bus introduced its white services at or around the same time that 2 Travel began operating its commercial services

(see paragraph 2.39), and its withdrawal of those services largely coincided with 2 Travel's exit.⁴⁶¹

7.104 The OFT discusses below the coincidence in the introduction and routes of Cardiff Bus' white services with those of 2 Travel. The OFT concludes that these timings suggest that Cardiff Bus was not conducting a market test, but instead adopting an exclusionary strategy in response to 2 Travel's entry.

(i) Coincidence of timing in the introduction and withdrawal of the white services

7.105 Cardiff Bus registered all of its existing key corridor routes as frequent on 2 November 2003 and in the same month made preparations to use its reserve fleet (see paragraphs 7.99 onwards). At this stage, the minutes of the November Board meeting show that Cardiff Bus was readying its fleet to react to possible entry by 2 Travel that it expected might occur in the following month: 'The meeting noted that 2T have recently obtained an increase in its operator licence provision at Wentloog to 45 vehicles. A number of actions were being taken to address the potential for a competitive attack in the run up to Christmas including the retention of surplus vehicles'.⁴⁶²

7.106 However, the OFT notes that although Cardiff Bus was making its preparations in November 2003, it did not actually start running its white services for another five months. Furthermore, Cardiff Bus' first white service (the 117) started on 19 April 2004 - precisely the same day that 2 Travel's services started.

7.107 The OFT considers that this evidence does not support Cardiff Bus' explanation that it was conducting a market test, given that it had registered its routes and was preparing its fleet five months before. Cardiff Bus argued that it: '...recognised that 2 Travel may have come

⁴⁶¹ Schedule of white services provided by Cardiff Bus in response to the OFT's SO, on 11 July 2005.

⁴⁶² Minutes of Cardiff Bus Board meeting, 11 November 2003.

up with a service for which there was customer demand, and Cardiff Bus accordingly set out to test the market itself (rather than sitting on the sidelines and giving 2 Travel a head start in the market should the 'no frills' service prove to be successful)'.⁴⁶³

7.108 However, if Cardiff Bus had wanted to test the market for no-frills services, it could have done so before 2 Travel started its services, and therefore in the absence of any competition that would have otherwise affected the results of such a test. Instead, the evidence shows that Cardiff Bus was preparing for 'a competitive attack' from November 2003, and that it held off reacting until the exact day that its competitor actually entered the market.

7.109 Cardiff Bus implicitly confirmed this view when arguing in its written representations on the SO⁴⁶⁴ that the fact that it had run the 157/158 services demonstrated that its: '...genuine intention was to test the market for the services'. Cardiff Bus further stated:⁴⁶⁵ 'There was no reason for Cardiff Bus to operate these services if its real aim was to predate against 2 Travel. Given its frequent registrations, had Cardiff Bus' real aim been to predate against 2 Travel it could have waited until any 2 Travel services started on this route and then immediately begun to operate. As it was, Cardiff Bus operated these services consistently throughout most of the period'.

7.110 However, the OFT notes that Cardiff Bus **did** wait until 2 Travel services had started before introducing its white services on all its routes. Moreover, Cardiff Bus' decision to start the 157/158 service at the same time as it started its 162, 144 and 150 services is consistent with it being unsure whether and when 2 Travel might start a 258 service and suggests that its intention was to counter 2 Travel's possible entry. Moreover, Cardiff Bus ran its 157/158 service despite losses from the outset and throughout (see Section F), withdrawing them in October 2004, by which time 2 Travel's problems had become manifest.

⁴⁶³ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 40.

⁴⁶⁴ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, paragraph 2.18.

⁴⁶⁵ Ibid.

- 7.111 Likewise, Cardiff Bus' decision to withdraw its white services at around the same time as 2 Travel exited is also not consistent with its explanation that it wanted to test demand for its own no-frills services. The OFT would have expected that Cardiff Bus would have retained its white services to assess how they fared in the absence of competition, in particular, given that it had not done so beforehand.
- 7.112 In its written representations on the SSO,⁴⁶⁶ Cardiff Bus argued that it '...was reluctant to provide a "no frills" service to consumers, but in light of 2 Travel's entry, and as evidenced by contemporaneous documents felt "bound" to do so'. In this respect, the LECG report⁴⁶⁷ annexed to Cardiff Bus' representations on the OFT's SSO also stated that '...[i]f Cardiff Bus had not acted on the entry of 2 Travel and 2 Travel had built up first mover advantages in the form, say, of a reputation as the no-frills bus service provider in Cardiff, Cardiff Bus might never have been able to enter with its own services. Since entry did not involve large costs, it made much more sense for Cardiff Bus to just enter and see, rather than wait and risk losing out forever on the opportunity'. LECG also argued⁴⁶⁸ that 2 Travel's entry and exit decisions were a good signal to Cardiff Bus about the profitability or otherwise of the market, and thus Cardiff Bus' entry pattern should not be seen as evidence of abuse. The OFT rejects these arguments for the reasons set out below.
- 7.113 As an initial observation, the OFT notes that LECG's explanation for Cardiff Bus' conduct is an entirely theoretical reconstruction and is not based apparently on any evidence or reasoning actually followed by Cardiff Bus at the time. Furthermore LECG's argument is based upon assumptions that are not soundly based.
- 7.114 Firstly, the OFT considers that a material first mover advantage was unlikely in this case for the following reasons:

⁴⁶⁶ Cardiff Bus written representations on the OFT's SSO, dated 1 August 2008, at paragraph 6.36(a).

⁴⁶⁷ LECG report, dated 1 August 2008, page 8.

⁴⁶⁸ Ibid.

- If Cardiff Bus genuinely thought that there was a first mover advantage it is surprising that it chose not to make use of that first mover advantage itself. Cardiff Bus started its preparations for the white services in November 2003 in anticipation that 2 Travel would launch its services in December 2003 (see paragraphs 7.99 to 7.101). When 2 Travel's entry did not materialise in December, Cardiff Bus waited and launched its own white services at the same time as 2 Travel in April 2004. Thus Cardiff Bus did not take up the opportunity to take a first mover advantage of its own, implying that Cardiff Bus either did not believe such an advantage existed or at least any such advantage was not central to its thinking. Indeed, the OFT notes that in January 2004, Cardiff Bus considered selling off its no-frills fleet because it appeared at that time that the threat from 2 Travel had receded.⁴⁶⁹
- Contrary to LECG's claims about reputation,⁴⁷⁰ the OFT considers that no-frills bus services were unlikely to generate brand loyalty, especially given Cardiff Bus' decision to use understated livery for its white services.
- Also in this case there were no network effects related to the provision of no-frills services that could have justified a first mover advantage.

7.115 Even if there had been a first mover advantage in this case, it would have been short lived and the benefits of pre-emption substantially reduced given the certain subsequent entry by the follower.

7.116 Secondly, as stated in paragraph 7.19, Cardiff Bus was in a materially different position to 2 Travel. Cardiff Bus was the incumbent operator already operating normal services, and hence facing different incentives to introduce no-frills services to 2 Travel. Furthermore, it operated a

⁴⁶⁹ See Cardiff Bus' Managing Director's report for 5 January 2004 which, under the heading 'Competition', states: 'There is no change to the current competitive position. Given the lack of any movement by competitors the company is now in a position to start disposing of additional vehicles retained as a safeguard if competition had emerged before Christmas'.

⁴⁷⁰ See LECG report, dated 1 August 2008, page 8.

different business model to that adopted by 2 Travel for its no-frills services, since 2 Travel did not appear to incur incremental driver costs to run its no-frills services,⁴⁷¹ whereas Cardiff Bus diverted drivers from its normal services or recruited additional drivers specifically for the white services (see paragraphs 7.141 onwards). As a result of these differences, the decision by 2 Travel to launch its no-frills services could not be relied on by Cardiff Bus as an accurate signal of a profitable business opportunity for its own white services.⁴⁷²

7.117 In terms of exit, the OFT does not agree with LECG's argument that 2 Travel's exit was a good signal to Cardiff Bus about the profitability or otherwise of the market. When 2 Travel exited the market in December 2004 it did not merely stop its no-frills services. 2 Travel stopped **all** services, including tendered services, in Cardiff and closed its Cardiff depot.⁴⁷³ Cardiff Bus was aware that 2 Travel was in financial difficulties (see the discussion at paragraphs 7.137 to 7.140) but would not have known whether these difficulties related to the no-frills services or its services more generally in Cardiff or other factors. As a result the ceasing of **all** 2 Travel services in the Cardiff area would not have provided a good signal as to the continued profitability of Cardiff Bus' no-frills services, even if Cardiff Bus and 2 Travel had been employing similar business models, which as is explained above they did not.

⁴⁷¹ See 'Bus Wars' – article in South Wales Echo, dated 17 March 2004, which quotes 2 Travel's Operations Director, David Fowles, as saying: 'Our drivers do not do an awful lot between the school runs but we have to pay them. So we are using the capacity on five corridors to operate commercial services around our school services, finishing at around 6pm'.

⁴⁷² Cardiff Bus appeared to be aware that 2 Travel did not have to incur incremental driver costs to start its no-frills services. See Cardiff Bus press release dated 13th April 2004, titled 'Nothing new' offered by limited competitive bus services', which states: 'The fact that the company is not providing any new links within the city; is not using modern low floor easy accessible vehicles; and *only operating at times that are convenient to them*, indicates that this is not about improving public transport in Cardiff – it seems to be simply a means of raising cash' (emphasis added).

⁴⁷³ See paragraphs 2.44 to 2.45

(ii) Coincidence in the routes for white services and 2 Travel's services

7.118 The white services were introduced only on those commercial bus routes served by 2 Travel and on one additional route that 2 Travel had registered with the Traffic Commissioner, but subsequently did not operate (the '258 service').

7.119 An article in the Coach and Bus Weekly dated 29 July 2004, attributes David Brown as stating that it is '...co-incidence that the white services run on the same corridors as 2 Travel services'. David Brown is also attributed as saying 'We don't want bus wars – effectively we're experimenting with white minibuses to see if the market is there'.⁴⁷⁴

7.120 However, Cardiff Bus subsequently claimed in its written representations on the SO⁴⁷⁵ that the routes chosen for the white services were those most likely to be profitable.

7.121 The OFT considers that although the profitability of the routes may have been a consideration in its choice, it does not explain why Cardiff Bus, having registered all of its key corridor routes as frequent with the Traffic Commissioner, could not for example also have chosen one or more of its routes on which it faced no competition to test out the no-frills concept.

(c) The costless transferability of the white services' tickets

7.122 As noted above, return tickets purchased on white services could be used on normal services (and vice versa). This had the effect of changing the pricing structure of Cardiff Bus fares compared with those of 2 Travel.

7.123 In its written representations on the SSO,⁴⁷⁶ Cardiff Bus stated that interchangeable tickets are a 'genuine consumer benefit' rather than

⁴⁷⁴ Coach and Bus Weekly, 29 July 2004.

⁴⁷⁵ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007.

⁴⁷⁶ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 6.39.

evidence of an 'illegitimate reaction to competition'. The OFT accepts that making return tickets transferable allows consumers greater flexibility in the timing of their journey.⁴⁷⁷

- 7.124 However, the OFT considers for the reasons set out below that Cardiff Bus' decision to make white service return tickets usable on normal services **at no extra cost** was another element of its exclusionary strategy.
- 7.125 For passengers, the attractiveness of the white services was enhanced because consumers could buy a return ticket on the outward white service and then use it to return on Cardiff Bus' higher quality and more frequent normal buses for their return journeys, at no additional cost. By allowing access to the higher quality service on the return leg, this made Cardiff Bus' white services preferable to 2 Travel's no-frills services.
- 7.126 The OFT also notes that 2 Travel's single fares for the first three zones were set at a level equal to the difference in price between a corresponding return and single ticket for Cardiff Bus' normal services. This meant that it cost the same for a customer to make outward and return journeys on Cardiff Bus' normal services or to make one journey on Cardiff Bus normal services and the other leg on 2 Travel service.⁴⁷⁸ However, by enabling passengers to buy a return ticket on white services and use this ticket to travel back on its normal services at no additional cost, Cardiff Bus further undercut 2 Travel's fares, by making an outward journey on the no-frills white services and return on the normal service possible at the lower white service return fare.⁴⁷⁹

⁴⁷⁷ Although it is worth noting that, even if white service tickets had not been transferable, passengers could have simply purchased a single ticket on the white services and they would still be able to catch the first available bus on their return leg, whether it was a normal or a white service bus.

⁴⁷⁸ For example, at the time of the no-frills services, a passenger could pay 80 pence for a single adult two-zone ticket with 2 Travel and return using a 95 pence single adult Cardiff Bus normal service ticket (for a total cost of £1.75), or buy a two-zone normal return ticket on Cardiff Bus (for a total cost of £1.75).

⁴⁷⁹ This was even true for Zone 1, where 2 Travel's single fares were cheaper than the white services' fares: a user could pay 50 pence to travel out on a 2 Travel bus and 65 pence to

- 7.127 Transferability is likely to have increased the number of existing passengers switching from normal services to white services on the outward leg because they could still use normal services on the return leg. To the extent that these passengers would not otherwise have bought a white service return ticket had it not also allowed them to catch a normal service on their return leg, transferability to the normal services at no additional cost would have resulted in a cannibalisation effect (in other words sacrificed revenue) on Cardiff Bus' normal services.
- 7.128 This appears to make no business sense unless it was to foreclose passengers to 2 Travel, by encouraging white service customers to buy return tickets, which were valid for the return leg on Cardiff Bus' normal and white services, thus reducing the number of potential passengers for 2 Travel's services.
- 7.129 The OFT also notes that as an alternative to its chosen policy, Cardiff Bus could have allowed consumers with white service return tickets to catch normal services by paying the fare difference to reflect the higher quality/frequency of service on the return leg, thus offering passengers flexibility in journey while also avoiding any sacrifice in revenue.
- 7.130 In the OFT's view, the choice by Cardiff Bus to make return tickets purchased on white services transferable to normal services **at no extra cost** was likely to involve a sacrifice of revenue for Cardiff Bus while also having the effect of limiting the number of passengers on 2 Travel services. Thus the OFT believes that Cardiff Bus' choice of pricing of transferable tickets is further evidence that Cardiff Bus' conduct was motivated by a desire to exclude 2 Travel rather than normal commercial motivations.

return on a Cardiff Bus normal service (at a total cost of £1.15), or instead pay only £1.10 to travel out on a Cardiff Bus white service but travel back on its normal service.

(d) Evidence that the impact on 2 Travel was Cardiff Bus' key success measure

7.131 The OFT also notes that while Cardiff Bus has provided no convincing internal contemporaneous evidence that it was conducting a market test, it is clear from contemporaneous Board minutes and reports that 2 Travel's entry, and Cardiff Bus' reaction in terms of operating its white services, were discussed.

7.132 However, the nature of these discussions at that time does not suggest that the Board was receiving reports on the success or otherwise of the white services in terms of demand and profitability, as the OFT would have expected in the case of a market test.⁴⁸⁰ Indeed there is no mention of there being a market test. Instead, the Board minutes suggest that discussions (under the Agenda Item heading 'Competition') about the white services primarily focused on 2 Travel's circumstances. For example:

- The Managing Director's report of 4 May 2004⁴⁸¹ stated: '...whilst the company response has been professionally executed, the 2 Travel service has been ragged and unreliable. The full service has not been run due to driver shortage, and the services that remain have kept neither to timetable nor route...Early indications are that patronage has been poor with no clear demand emerging for a no frills service at this early stage, although the market will of course develop'.

⁴⁸⁰ In its written representations on the OFT's SSO, dated 1 August 2008, Cardiff Bus stated: '...In fact, as stated in the Response to the SO and ignored by the OFT, more detailed analysis of the "no frills" services was carried out in the full management team reports; see for example OFT document 46 at page 44'. However, the OFT notes that the document referred to by Cardiff Bus contains only a year-on-year comparison for passenger numbers and revenue at an aggregated level. For instance, it shows results for the Ely 'subgroup' which includes the 117 service but in combination with the results for the 4, 12, 12A, 13, 17 and 18 services. Because the results of the white services were not distinguishable from all the other services running along the routes, these data do not amount to evidence that Cardiff Bus' management was analysing the no-frills services.

⁴⁸¹ Managing Director's report to the Cardiff Bus Board, 4 May 2004.

- The Managing Director's report of 14 October 2004⁴⁸² made no reference to running a market test, nor to the performance of the white services, which it referred to as Cardiff Bus' 'competitive response'. Instead, it focused on 2 Travel and concerns about its '...failure to operate a registered service in its entirety since its inception...failure to keep to timetable or to route, breaches of PCV regulations', etc.
- The Managing Director's report of 30 November 2004⁴⁸³ stated, with reference to 2 Travel, that: 'Media reports indicate that Insolvency practitioners have been appointed, presumably with a view to clarifying the company's solvency, and its ability to trade out of its current difficulties. Clearly the company is in significant difficulties, and there must be a considerable question mark over whether the company is able to continue trading'.

7.133 Again, this evidence conflicts with Cardiff Bus' suggestion that it had introduced the white services as a market test. Instead, it demonstrates that the purpose of the white services was as a retaliatory response, and that any assessment by Cardiff Bus focused on how its competitor was faring. The only reference to any assessment by Cardiff Bus of whether there was demand for no-frills was on 4 May 2004 – less than two weeks after most of Cardiff Bus' white services had started. Furthermore, given the nature of its 'observation' programme described below, it is not clear that this assessment was of its own white services, rather than 2 Travel's. To the extent that the Managing Director's report of 4 May 2004 represented an assessment of the white services, the OFT notes that it suggests that even at this stage it should have been apparent to Cardiff Bus that it could be making a loss on its white services.

7.134 In particular, the OFT notes that one of Cardiff Bus' proposed actions in its Competition Policy document (see paragraphs 7.89 onwards) was: '...a programme of obtaining loadings from other sources and

⁴⁸² Managing Director's report to the Cardiff Bus Board, 14 October 2004.

⁴⁸³ Managing Director's report to the Cardiff Bus Board, 30 November 2004.

geographical points so that we can establish exactly the market penetration of the competition and the estimated number of passengers being carried per week'. In response to a section 26 notice,⁴⁸⁴ Cardiff Bus supplied the OFT with sheets it had used to gather observations on passenger numbers. See Figure 24 for some examples of these sheets (called 'Competitive Services Logs'). In total, Cardiff Bus provided to the OFT approximately 1,170 pages of such record sheets covering the period from 19 April 2004 to 17 December 2004.⁴⁸⁵

7.135 The OFT considers that factors relating to these records are further evidence that Cardiff Bus' white services were a reaction to 2 Travel's entry and not a market test. In particular, the OFT notes that:

- Cardiff Bus claims that its Competitive Service Logs exercise focused on collecting data on its own services, rather than on 2 Travel's no-frills services.⁴⁸⁶ However, the OFT notes that Cardiff Bus halted its data recording on 17 December 2004 – precisely the same day that 2 Travel exited the Cardiff market, despite continuing to run its 144 and 150 services until 18 February 2005 (the success of which Cardiff Bus might have been expected to continue to monitor in the absence of competition, had this been a market test as it claimed).
- Cardiff Bus appears only to have collected such data on loadings for services where it was competing with 2 Travel. It does not appear to have collected the same data for its 157/158 services, which the OFT would have expected it to do had this been a market test and given that these services were the only ones where

⁴⁸⁴ Letter to the OFT dated 14 September 2005, responding to the OFT's section 26 notice dated 26 May 2005.


⁴⁸⁵ This significant observation exercise may also have entailed additional costs to those identified in the OFT's assessment of costs in Section F, to the extent that any observations were made and forms completed outside the 'drivers payroll' hours data supplied by Cardiff Bus.

⁴⁸⁶ In its written representations on the OFT's SSO, dated 1 August 2008, at paragraph 6.43, Cardiff Bus stated that: 'The vast majority of services monitored by Cardiff Bus in their Competitive Services Logs were in fact Cardiff Bus services'. The OFT does not agree that the 'vast majority' of services monitored were Cardiff Bus services'. A substantial proportion of the individual services recorded in the records were 2 Travel services.

the white services could be assessed without the effects of competition affecting the analysis.

- It appears from the volume of record keeping that Cardiff Bus was prepared to put substantial effort into monitoring the activities and loadings of 2 Travel, when the OFT would have expected it to concentrate these resources on assessing its own services, had this been a market test. This volume of record keeping also appears contrary to the assertions of Cardiff Bus that it is a 'small company' whose communications are informal (see paragraph 7.61).

Figure 24: Examples of Cardiff Bus' Competitive Services Logs⁴⁸⁷



COMPETITIVE SERVICES LOG

Day: THURSDAY		Data Collector: [...][C]	
Date: 22 nd APRIL 2006		Weather: RAIN CLOUDY	

Service Number	Destination	Fleet/Reg No.	Scheduled Time	Actual Time	PASSENGERS			Point of Observation	Remarks
					Boarded	Alighted	Carried		
245	CITY CENTRE	D202FYM		09:30	0	0	4	GREY FRIAR'S RD	RED DOUBLE DECKER
245	ST MELLONS	D202FYM		09:40	1	0	1	GREY FRIAR'S RD	SHOWING NOT IN SERVICE ON PROPER DESTINATION
250	LLANRUISH	B966YR		09:43	0	0	0	GREY FRIAR'S RD	NOT SHOWING CORRECT DESTINATION
245	CITY CENTRE	L836CO9		09:48	0	0	4	GREY FRIAR'S RD	
250	CITY CENTRE	F293AWW		09:49	0	0	4	GREY FRIAR'S RD	
250	CITY CENTRE	L834CO9		09:58	0	0	1	GREY FRIAR'S RD	
250	LLANRUISH	F293AWW		10:01	0	0	0	GREY FRIAR'S RD	DRIVER LEFT 10:10.
245	ST MELLONS	L836CO9		10:34	0	0	0	GREY FRIAR'S RD	
250	LLANRUISH	L834CO9		10:36	0	0	0	GREY FRIAR'S RD	
250	CITY CENTRE	B966YR		10:42	0	0	3	GREY FRIAR'S RD	
244	ST MELLONS	S929YK		10:44	0	0	3	GREY FRIAR'S RD	
245	CITY CENTRE	D202FYM		10:51	0	0	0	GREY FRIAR'S RD	DRIVER WEARING A EAR PIECE
250	CITY CENTRE	F293AWW		11:09	0	1	3	GREY FRIAR'S RD	
245	ST MELLONS	D202FYM		11:19	0	0	2	GREY FRIAR'S RD	DIFFERENT DRIVER TO ONE THAT CAME INTO CITY CENTRE
245	CITY CENTRE	L836CO9		11:24	0	0	12	GREY FRIAR'S RD	
250	LLANRUISH	B966YR		11:36	0	0	0	GREY FRIAR'S RD	
250	CITY CENTRE	L834CO9		11:41	0	0	1	GREY FRIAR'S RD	
245	ST MELLONS	L836CO9		11:44	0	0	1	GREY FRIAR'S RD	CHANGED DRIVER'S
244	CITY CENTRE	S929YK		11:53	0	0	2	GREY FRIAR'S RD	

Notes					
FARES ARE ADULT 50P SINGLE CHILD 30P SINGLE	RED ZONE	YELLOW ZONE ADULT 80P SINGLE CHILD 50P SINGLE	GREEN ZONE 10P SINGLE 70P SINGLE	BLUE ZONE 20P SINGLE 80P SINGLE	NOTHING ABOUT RETURNS DISPLAYED

Cardiff City Transport Services Limited Continue overleaf if required

⁴⁸⁷ The examples of the logs in this Decision are intended to show how the logs were being used to record data on 2 Travel as well as Cardiff Bus services. In its written representations on the OFT's SSO, dated 1 August 2008, Cardiff Bus stated that: '...In relation to the Competitive Services Logs, the OFT puts forward in the SSO an unrepresentative example which appear to largely detail monitoring of 2 Travel services. The vast majority of services monitored by Cardiff Bus in their Competitive Services Logs were in fact Cardiff Bus services'. However, as noted in footnote 486, the OFT does not agree that the 'vast majority of services monitored by Cardiff Bus in their Competitive Services Logs were in fact Cardiff Bus services'. The OFT also notes that the logs contained space for observers' remarks and that any detailed comments recorded were invariably about 2 Travel's services' punctuality and quality, rather than the white services. Some logs only recorded 2 Travel services but included comments such as '...ours in front or '...three passengers waited for ours', which suggest that the observer was not concerned with recording the white services on the route, but with how 2 Travel was faring.



LRY to 4 to 4 part
ST. M. 4 to 4 part

①

COMPETITIVE SERVICES LOG

Day: WED Date Collector: [...][C]
Date: 21 Oct 04 Weather: DAMP / SLEET

COMPLETE NEW SHEET FOR EACH PORTION OF DUTY

Service Number	Destination	Fleet/Reg No.	Scheduled Time	Actual Time	PASSENGERS			Point of Observation	Remarks
					Boarded	Alighted	Carried		
250	CITY CR	LRY	09:28					LRY L/CR	DID NOT OPERATE *
250	"	"	09:58					"	" " " *
250	"	B886 YR	10:28	10:26	-	-	4	"	1/B
250	"	F293 ANW		10:18	-	-	0	"	0/B
250	"	F293 ANW		10:40	-	-	5	"	1/B (S) + PICKED UP 3 PASSENGERS 10 MIN
245	"	AYS 100T		11:00	-	-	8	TOWN RD	1/B NEW RD 1/B! (NOT RHYL RD)
244	"	L836 COG		11:05	-	-	7	POTTERS WHEEL	0/B (MAINLY BRIDGES)
244	"	L836 COG	11:15	11:15	-	-	2	ST M	1/B TOWN RD 11:25 (6) PASSENGERS REQUESTED TO REVERSE
244	"	L299 MHC	11:45	11:48	-	-	0	ST M	1/B (6) PASS BRIDGELA RD STAYED BEHIND OUR SERVICE " GAVE WAY FOR US TO PULL OUT!
250	NO	BUS	10:58					LRY L/CR	NOT OPERATED * (FROM G. SERVICE)
"	"	"	11:28					LRY L/CR	NOT OPERATED * (FROM G. SERVICE)
"	"	"	11:58					LRY L/CR	NOT OPERATED * (FROM G. SERVICE)
244	CITY CR	B886 YR	12:15	12:23	-	-	0	RICK HOWELL RD	1/B (TRANSFORMER MOUNTED)
244	"	L929 MKC	13:15	13:13	-	-	1	KHIL SAND (13:13)	1/B TOWN RD 11:25 (6) PASSENGERS REQUESTED TO REVERSE
250	"	B886 YR	13:58	13:51	-	-	0	LRY L/CR	7 MINS EARLY 1/B (EMPTY TO NEW RD)
250	LRY	F293 ANW		14:26	-	-	1	PALL RD	0/B
250	CITY CR	F293 ANW	14:29	14:43	-	-	3	LRY L/CR	1/B KILSE
250	CITY CR	"	14:58					LRY L/CR	NOT OPERATED *

Notes: COLUMN 3. *250 B886 YR (LEFT POINT 10:05 - PICKED UP 10:18 EARLY STOP - (PALL RD 0/B - LRY AND 1/B * 2 PAS 10:22 MIN) F293 ANW ← DON'T STOP 10:30 RETURNED BACK (SOME 2T. TRYING TO PICK UP - REST DON'T SEEM CONCERNED)

Cardiff City Transport Services Limited

Continue overleaf if required



COMPETITIVE SERVICES LOG

Day: TUESDAY Date Collector: [...][C]
Date: 20-1-2004 Weather: SHOWERS

COMPLETE NEW SHEET FOR EACH PORTION OF DUTY

Service Number	Destination	Fleet/Reg No.	Scheduled Time	Actual Time	PASSENGERS			Point of Observation	Remarks
					Boarded	Alighted	Carried		
117	CBS	103		09:51	0	0	10	PENDING, ELY	
117	ELY	112		09:55	0	0	2	"	
217	CBS	L702	09:54	09:57	0	0	11	"	
217	ELY	L710	10:10	10:01	0	0	0	"	9 MINS EARLY
217	CBS	L710	10:25	10:20	0	0	3	"	5 MINS EARLY
117	CBS	112		10:24	0	0	5	"	
117	ELY	103		10:24	0	0	0	"	
217	ELY	L702	10:40	10:34	0	0	0	"	6 MINS EARLY
117	CBS	103		10:51	4	0	12	"	
117	ELY	112		10:52	1	0	1	"	
217	CBS	L702	10:56	10:53	0	0	1	"	3 MINS EARLY
217	ELY	L710	11:10	10:58	0	0	4	"	12 MINS EARLY
117	CBS	112		11:18	5	0	12	"	
217	CBS	L710	11:25	11:19	0	0	4	"	6 MINS EARLY
117	ELY	103		11:25	0	1	1	"	
217	ELY	L702	11:40	11:35	0	0	0	"	5 MINS EARLY
117	CBS	103		11:50	0	0	8	"	
217	CBS	L702	11:56	11:52	1	0	2	"	4 MINS EARLY
117	ELY	112		11:56	0	0	3	"	

Notes:

Cardiff City Transport Services Limited

Continue overleaf if required



COMPETITIVE SERVICES LOG

Day: <u>MONDAY</u>	Data Collector: [.....]IC	
Date: <u>12/04/08</u>	Weather: <u>FINE</u>	

COMPLETE NEW SHEET FOR EACH PORTION OF DUTY

Service Number	Destination	Fleet/Reg No.	Scheduled Time	Actual Time	PASSENGERS			Point of Observation	Remarks
					Boarded	Alighted	Carried		
250	SERV. 85	X7R	09:10	09:23	0	2	5	CIR 7/B	NO DESTINATION / 4943 BEHIND.
50	C/CENT	107		09:25	1	4	15	CIR 7/B	BAT/BUS
250	C/CENT	F29320	09:40	09:36	0	0	6	" "	
104	C/CENT			09:44	0	1	3		INFRONT OF 2 TRAVEL
245	NONE	B863XR	09:59	10:02	0	0	0	" " 7/B	
115	NONE			10:05	0	1	4	" " 7/B	B/BUS BEHIND 2 TRAVEL
245		9129	10:25	10:10	6	0	6	" " 7/B	
150	C/CENT	107		10:14			4	" " 7/B	B/BUS
150	C/CENT	116		10:23			3	" " 7/B	B/BUS
250	B SERVICE	B866	10:16	10:27	0	0	2	" " 7/B	
Notes									

Cardiff City Transport Services Limited

Continue overleaf if required

7.136 In its written representations on the OFT's SSO,⁴⁸⁸ Cardiff Bus stated that: it is clear from the content of the Managing Director's Reports for the period that these give a general overview of the overall performance of Cardiff Bus. In this context it would have been inappropriate to focus extensively on the individual successes of a limited number of services. On the other hand competition had always been a subject on which the Managing Director was expected to report, before, during and after the brief period of 2 Travel's entry into and exit from Cardiff'. However, as noted in paragraphs 7.132 to 7.133, the Managing Director's Reports did address the no-frills services, but the discussion focused not on Cardiff Bus' performance but on 2 Travel as a competitor. The only topic of discussion under the Agenda Item 'Competition' during the period in which the white services were operated was 2 Travel.

⁴⁸⁸ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 6.42.

(e) Evidence that the withdrawal of white services was triggered by 2 Travel's exit

7.137 As noted in paragraph 7.61, Cardiff Bus has not been able to produce any internal contemporaneous evidence to corroborate its argument that its decision to withdraw the white services was taken on the basis of analysis and a finding of unexpected lack of customer demand. Instead, the internal evidence suggests that its ongoing assessment of the threat posed by 2 Travel was the key factor influencing Cardiff Bus' decisions on when to withdraw its services - including during the two months that followed 2 Travel's exit.

7.138 Cardiff Bus started withdrawing its white services almost immediately after it became apparent that 2 Travel would be exiting the commercial bus market. On 20 December 2004 Cardiff Bus received information that 2 Travel had withdrawn from Cardiff.⁴⁸⁹ The next day, Cardiff Bus withdrew its white service number 117.⁴⁹⁰ Similarly, in an email dated 5 January 2005, the Managing Director of Cardiff Bus commented that he had been informed by a reliable source that 2 Travel would lose its operating licence on 22 January 2005 and noted that: 'This is presumably open to appeal. This looks therefore like the end of 2 Travel but we have seen them come back before so lets just remain a little cautious until everything is formally confirmed'.⁴⁹¹ Cardiff Bus withdrew white service number 162 on 14 January 2005.⁴⁹²

7.139 Finally, the withdrawal of the remaining white services 144 and 150 on 18 February 2005⁴⁹³ corresponds approximately with a team briefing note of February 2005⁴⁹⁴ which states that: '2 Travel pulled out of Cardiff shortly before Christmas and is now only operating in West Wales. Our view is that it is unlikely that they will return to Cardiff'.

⁴⁸⁹ Cardiff Bus Team Brief, December 2004 paragraph iii.

⁴⁹⁰ Schedule of white services prepared by Cardiff Bus, dated 1 July 2005.

⁴⁹¹ Email from the Managing Director to various members of Cardiff Bus, dated 5 January 2005.

⁴⁹² Schedule of white services prepared by Cardiff Bus, dated 1 July 2005.

⁴⁹³ Ibid.

⁴⁹⁴ Cardiff Bus Team Brief, February 2005, paragraph iii.

7.140 Cardiff Bus' assessment that 2 Travel no longer represented a threat to it appears confirmed by a team brief in March 2005,⁴⁹⁵ which stated: 'We understand that the appeal by 2T in relation to loss of licence has resulted in their licence being reinstated for a limited number of vehicles. This seems to us to be unjust, but as they are showing no signs of returning to Cardiff is no longer a key issue for us'.

(i) Staff shortages

7.141 In its section 26 responses as well as its written and oral representations on the SO, Cardiff Bus referred to driver shortages as being one of the reasons for the withdrawal of the white services.

7.142 At the oral representations hearing, Cardiff Bus' Managing Director stated: 'But we were overtaken by events when a shortage of drivers, in fact it was the same shortage of drivers that 2 Travel were experiencing at that time, meant that we weren't able to operate our full range of services, and I think it's no surprise to anybody that if you can't operate all your services and you decide on which ones to cut, that in our case it was the no frills services that got the chop, and over a period of time we closed down our no frills operation'.⁴⁹⁶

7.143 However, the OFT considers that the evidence suggests that Cardiff Bus was prepared to divert staff to white services and, indeed, that the driver shortages were caused in part by the introduction of the white services.

7.144 The issue of drivers was referred to as early as May 2004 in the Managing Director's note⁴⁹⁷ which states: 'The company has enjoyed an extended period of full staffing, which together with effective management has meant minimal loss of mileage arising from staff shortages. With the additional staff requirements resulting from competition, combined with the main summer holiday period, the

⁴⁹⁵ Cardiff Bus team brief, March 2005.

⁴⁹⁶ Transcript of oral representations hearing, 15 October 2007 at line 7 page 11.

⁴⁹⁷ Cardiff Bus Managing Director's report, 4 May 2004.

situation will become more difficult in the months ahead. The company is currently actively recruiting to meet this requirement'.

- 7.145 A further note⁴⁹⁸ by the Managing Director, dated 14 October 2004, indicates that Cardiff Bus was experiencing driver shortages by September 2004 and notes that these shortages were made worse as a result of the white services: '...the company is currently operating with a deficit of drivers and this has led to problems with service provision in September. The position is exacerbated as a result of having diverted 17 drivers to our White Bus service. Recruitment of drivers is currently underway to address this problem'.
- 7.146 The OFT notes that this evidence suggests that, despite experiencing problems providing its services because of staff shortages in September and October 2004, Cardiff Bus continued to run its white services having diverted staff to them from its normal services. Rather than cutting its white services at this stage, as Cardiff Bus' oral representations suggested, it was apparently recruiting new drivers to cover the shortfall.
- 7.147 The OFT also notes that this evidence clearly indicates that Cardiff Bus' Managing Director referred in his May 2004 Report⁴⁹⁹ to '...additional staff requirements *resulting from competition...*' [emphasis added], rather than to staff being needed to support a market test as would have been expected had that been the reason for introducing the white services.
- 7.148 In its written representations on the SSO,⁵⁰⁰ Cardiff Bus stated that: 'Such staff shortages are likely to have arisen or been exacerbated whatever type of additional services were put on by Cardiff Bus and for whatever reason. In light of this the fact that the white services were not cut when staff shortages were reported (from September 2004) is likewise unhelpful to the OFT's case. Clearly the staff shortages played

⁴⁹⁸ Managing Director's report, 14 October 2004.

⁴⁹⁹ Managing Director's report, 4 May 2004.

⁵⁰⁰ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 6.21.

a part in Cardiff Bus' decision making and the eventual withdrawal of the white services, but this is not inconsistent with Cardiff Bus deciding to launch the services or to continue them for a period in spite of staff shortages'.

7.149 However, the OFT rejects this argument. Cardiff Bus' decision to divert drivers to run its white services was made despite the negative impact on its normal services and the losses that the white services were making (see Section F). In combination with the other evidence presented in this Decision, it is clear that Cardiff Bus' rationale was to maintain its exclusionary conduct whilst 2 Travel continued to present a threat.

F Analysis of costs and revenue

7.150 Considered in the round, the OFT concludes that the evidence is sufficient to demonstrate that Cardiff Bus ran its white services not as a market test, but as a competitive response to 2 Travel's entry.

7.151 This Section sets out the evidence which, in the OFT's view, is sufficient to demonstrate that the launch and continued operation of the white services was loss-making for Cardiff Bus. This analysis uses the historical data available – data that became available to Cardiff Bus during the operation of the white services. The analysis shows that the white services were not profitable ex post on an incremental basis, and that these losses should quickly have become clear to Cardiff Bus.⁵⁰¹ Cardiff Bus have argued that demand for its services were unexpectedly low, and thus the analysis should focus on the ex ante expected profitability rather than the ex post actual profitability.⁵⁰² However, in the absence of any business plan or other contemporaneous pre-launch evidence of anticipated costs and revenues on which to base the analysis, such ex ante analysis is not possible on a reliable basis.

⁵⁰¹ As noted in paragraphs 7.132 to 7.133, on 4 May 2004, less than two weeks after the white services started, the Managing Director's report to the Cardiff Bus Board noted that patronage on the no-frills service was 'poor'.

⁵⁰² Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 50, paragraphs 6.2 onwards.

7.152 The Section discusses in turn:

- i. analysis of costs and revenue and the OFT's methodology,
- ii. the results of the costs and revenue analysis, and
- iii. the OFT's conclusions on the costs and revenue analysis.

i. Analysis of costs and revenue and the OFT's methodology

7.153 The OFT's analysis of costs and revenue involves a consideration of the:

- (a) relevant cost benchmark,
- (b) relevant level of output,
- (c) relevant time period over which to measure revenues and costs,
- (d) costs included in the analysis, and
- (e) revenues included in the analysis.

(a) The relevant cost benchmark

7.154 Competition authorities can use a variety of cost measures to determine whether a dominant firm incurred short-term losses. The appropriate cost benchmark may vary from case to case, and the facts in each case will determine the appropriate measure of cost.⁵⁰³

7.155 Variable costs are costs that vary directly with output over the relevant timeframe. Avoidable costs are those that could have been avoided if the undertaking had not engaged in the activity or ceased to engage in the activity.

7.156 In the present case, the OFT has considered two bases for assessing costs: average variable costs (AVC) and average avoidable costs (AAC). This approach has been used in several OFT cases, such as in *Aberdeen*

⁵⁰³ For a description of the different concepts involved, see for example the OFT's draft guideline, *Assessment of conduct* (OFT414a), April 2004, paragraphs 4.6 to 4.10.

Journals.⁵⁰⁴ In past cases these two bases have been shown to be very similar, since any cost that is variable over the period is also avoidable.

- 7.157 Often the AAC benchmark will be the same as the AVC benchmark, because in many cases only variable costs can be avoided. However, where the dominant company makes specific investments, such as expanding capacity in order to predate, then the fixed or sunk investments made for this extra capacity will be included within AAC, causing AAC to exceed AVC.
- 7.158 Given the circumstances of this case the AAC benchmark is the most appropriate. The assessment includes the cost of restoring the buses used on the white service routes. This preparatory work would not be considered a variable cost. However it is the OFT's view that these costs were avoidable. The cost could have been avoided if Cardiff Bus had not restored the buses. Alternatively, once restored, Cardiff Bus could have recovered at least part of the cost of restoration had the white services not run or ceased to run, either by transferring these, now serviceable, buses onto other routes or leasing the buses. For the avoidance of doubt, the OFT has demonstrated below (paragraph 7.207), that white service revenues did not exceed avoidable costs whether restoration costs are considered to be avoidable or not.
- 7.159 It is relevant to note that assessing Cardiff Bus' strategy relative to the AVC benchmark would have yielded a similar result. With the exception of restoration costs,⁵⁰⁵ all costs discussed in paragraphs 7.180 onwards do vary with output over the relevant timescale. This includes costs conventionally classified by the industry as semi-variable, such as insurance, road tax, depreciation and maintenance costs.
- 7.160 In the medium term, pricing below AAC is not in the economic interest of an undertaking, since by not providing the relevant output it would

⁵⁰⁴ See also, for example:

http://www.offt.gov.uk/advice_and_resources/resource_base/ca98/closure/British-Airways. Also http://www.offt.gov.uk/shared_offt/ca98_public_register/decisions/sky2.pdf (page 180).

⁵⁰⁵ Depreciation represents diminution in value that cannot be directly related to variation in output.

save more in costs than it would forego in revenue. In addition, the longer a dominant undertaking prices below AAC, the more likely it is that an equally efficient competitor would be forced to exit the market. This follows the same logic as the *AKZO* test as it has been applied in recent cases.⁵⁰⁶

7.161 The OFT therefore concludes that AAC is the most appropriate measure in this case, as it is the logical extension of the *AKZO* test, and it is relevant to a consideration of whether Cardiff Bus' conduct resulted in a loss. It also identifies the extent to which an equally efficient competitor would be able to operate profitably.

7.162 In its written representations on the SO,⁵⁰⁷ Cardiff Bus suggested that the correct analysis should be based on expected passenger numbers rather than actual numbers, because this would more clearly establish whether it intended to predate. In this respect, the OFT notes that Cardiff Bus could not provide contemporaneous evidence of what passenger numbers it was expecting when it started the white services. Moreover, as discussed in the previous Section, Cardiff Bus introduced its no-frills service with an approach that reduced its likelihood of success (for example, with little promotion and disparaging press releases).

7.163 Cardiff Bus also suggested in its written representations on the SO,⁵⁰⁸ that any test should establish the reasons behind a pricing decision and therefore be based on expected revenue, rather than historic revenue. In this respect, the OFT again notes that Cardiff Bus has not been able to provide any contemporaneous evidence of what revenue it was expecting when it started the white services. Also, as noted in Section

⁵⁰⁶ See, for example, *Aberdeen Journals*. Also see paragraphs 149 to 152 of *Tetra Pak II* T-83/91. At: http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61991A0083.

⁵⁰⁷ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 50, paragraphs 6.2 onwards.

⁵⁰⁸ *Ibid.*

E, in the OFT's view, Cardiff Bus was not genuinely testing whether a new no-frills service might be commercially successful.

(b) The relevant level of output

- 7.164 When assessing an allegation of predation, it is necessary to determine the correct output level to which to apply the cost analysis. This output level does not need to include all the products included in the relevant market.
- 7.165 In *Aberdeen Journals* predation occurred as a result of the incumbent reducing advertising prices and altering the format of one of three publications in response to a competitor's entry into the market. The CAT upheld the application by the OFT of the cost test to the Herald & Post only, which was the specific 'product' that represented the tactical response by Aberdeen Journals to competition.⁵⁰⁹
- 7.166 In the case of *NAPP Pharmaceuticals* the CAT upheld the application of the cost test to the predatory output alone, defined as the part of output sold at prices below cost, and including only hospital sales. The CAT rejected a claim that the cost test should be applied to the aggregate of all sales of the product in question, including community sales, saying that: 'In our judgment...a "net revenue approach" cannot, standing alone, constitute a defence to a charge of abuse by a dominant undertaking, unless it is accompanied by clear evidence that there was no intention or effect of foreclosing the market and impairing competition'.⁵¹⁰
- 7.167 In line with legal precedent, and as discussed in Sections B, C, D and E, the introduction of the white services constitutes in the OFT's view Cardiff Bus' tactical response to entry by 2 Travel, and is therefore the relevant level of output in the present case. This includes the 157/158 route, which the OFT considers was part of Cardiff Bus' tactical

⁵⁰⁹ Case No. 1009/1/1/02 *Aberdeen Journals Limited v Office of Fair Trading* [2003] CAT 11.

⁵¹⁰ Case No. 1001/1/1/01 *NAPP Pharmaceutical Holdings Limited and subsidiaries and Director General of Fair Trading* 12 January 2002, [2002] CAT 1, paragraph 259.

response. Although 2 Travel did not actually compete with Cardiff Bus on this route, by registering to run services on the route, it signalled its probable intention to do so.

7.168 In its written representations on the SO,⁵¹¹ Cardiff Bus sought to distinguish the facts in this case from those in the cases of *Napp*, *Aberdeen Journals* and *Compagnie Maritime Belge*. Its argument, that the appropriate cost base is normal and white services combined, cannot be accepted. Whilst it is right that the facts of all these cases differ, Cardiff Bus' argument, if taken literally, would mean that it could have priced its white services at close to or even at zero, provided that its variable costs of running all of its buses were covered by its total revenue. Such conduct, which could not be matched by an equally efficient competitor, and which had the further exclusionary effects set out in this Chapter, cannot be considered to be 'normal competition' consistent with the special responsibility borne by a dominant company.

7.169 The information gathered by the OFT during its investigation supports the view that Cardiff Bus' tactical response was to introduce the white services on the same routes served by 2 Travel (see Section E). The OFT found no evidence to suggest that Cardiff Bus implemented any unusual changes to its normal services operating on those routes prior to 2 Travel's entry.⁵¹² In arriving at this view, the OFT has also considered the following:

- **Timing** - Cardiff Bus introduced the white services to coincide with 2 Travel's entry to the market, as noted in Chapter 2 and Section E of this Chapter.
- **Pricing** - Cardiff Bus' fares for its white services were set well below its normal services and were lower than 2 Travel's no-frills

⁵¹¹ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 50, paragraphs 6.2 onwards.

⁵¹² Cardiff Bus did increase the fares it charged on normal services across its network in August 2004, including those services where it faced competition from 2 Travel (see Table 6). This was in line with Cardiff Bus' policy of annual fare increases.

fares for three out of four zones.⁵¹³ This contrasted with Cardiff Bus' normal services where prices continued to rise.

- **Livery** - The white services used different livery from that of the normal services. This instantly made the appearance of the white services distinct from the normal services operating on the same routes.
- **Scheduling** - The vehicles operated on a scheduling pattern that was different from that used by Cardiff Bus' normal services.
- **Vehicles** - The vehicles used on the white services were older no-frills vehicles than those used on the normal services. Passengers were therefore able to distinguish between the normal and the white services on the basis of the vehicles used.

7.170 In summary, the OFT takes the view that the white services, as distinct from the already existing normal services, constitute the relevant level of output in this case, as they represented the concerted response from Cardiff Bus to 2 Travel's entry into the market. This was demonstrated by Cardiff Bus' matching of its white service buses to the routes on which 2 Travel was operating.

7.171 Cardiff Bus suggested in its written representations on the SO⁵¹⁴ that allocating revenue and cost to individual routes resulted in a removal from reality. It argued that the normal and white services were in the same market and the OFT should have applied its analysis to the combined costs and revenue of these services. As outlined in the discussion above, the OFT considers that, in accordance with the relevant case-law, the appropriate output in this case is that of the distinct white services which constituted Cardiff Bus' response to 2 Travel's entry.

⁵¹³ See the information on fares at paragraph 2.52.

⁵¹⁴ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 48, paragraph 4.1

(c) The relevant time period over which to measure revenues and costs

7.172 Generally, the longer the period considered in an investigation of predation, the more costs become avoidable as commitments expire and/or alternative uses of the existing resources become available. It is therefore important to determine the appropriate time period to be used.

7.173 The relevant time period is usually that over which the alleged predatory conduct prevailed or could reasonably be expected to prevail. Whether the period taken is reasonable will be a matter of fact and degree to be assessed in the circumstances of each particular case.⁵¹⁵

7.174 Applying those principles in this case, the OFT has considered the period over which the white services were run. Each white service was operated for a slightly different time period, as described in Table 24. The table shows that in total, the activity on the white services spanned 10 months.

Table 24: Periods of operation of the white services

White service	Period of operation
117	19 April 2004 - 21 December 2004
157/158	26 April 2004 - 29 October 2004
162	26 April 2004 - 14 January 2005
144	26 April 2004 - 18 February 2005
150	26 April 2004 - 18 February 2005

Source: Schedule of white services provided by Cardiff Bus.

7.175 The OFT therefore considers that a 10-month period is appropriate for assessing avoidable costs in this case. Thus, avoidable costs include any cost that would have been avoided within the 10-month period, 19 April 2004 to 18 February 2005, had the white services not run. The results would not have been different had shorter periods been used (such as six months in the case of services 157/158) in the analysis.

⁵¹⁵ *Aberdeen Journals Limited v Office of Fair Trading* [2003] CAT 11, paragraph 354.

(d) **Costs included in the analysis**

7.176 The OFT asked Cardiff Bus to supply data showing costs and revenue for the white services.⁵¹⁶ Since the relevant level of output (the white services) is a subset of total output, this required some apportionment of revenue and costs to each route from data collected centrally. This apportionment allowed each white service to be examined separately from the rest of Cardiff Bus' network of normal services.

7.177 As part of the OFT's request, Cardiff Bus was asked to classify its costs on a route-by-route basis according to whether it regarded each cost as avoidable or sunk. Cardiff Bus indicated that, in its view, the following seven cost categories were avoidable: Drivers' payroll,⁵¹⁷ Fuel, Tyres, Lubricants, Insurance, Road tax and Maintenance.

7.178 The OFT considers that both restoration costs and depreciation of the buses should be included in addition to the seven categories of cost classified as avoidable by Cardiff Bus. These are set out in Table 25 below.

7.179 In the following Sections, the reasoning for considering costs as avoidable is outlined first and the method of allocation is then explained.

(i) Identification of avoidable costs

7.180 **Drivers' payroll** represents the cost of remunerating drivers to drive buses on the white service route. Given the length of time under consideration, if the white service had not operated the driver need not have been paid, or could have driven on a different route, so the costs are considered to be avoidable. Cardiff Bus' initial plan for the white service called for 13 drivers but only 11 were used, due to staff shortages.⁵¹⁸

⁵¹⁶ Section 26 notice to Cardiff Bus, dated 26 May 2005.

⁵¹⁷ Drivers' payroll was referred to as 'platform costs' in Cardiff Bus' route-by-route pro forma submission.

⁵¹⁸ Response to OFT's section 26 notice dated 15 December 2005, question 7 part B.

- 7.181 **Insurance** is a legal requirement and is included by Cardiff Bus as avoidable.⁵¹⁹ On this basis, the OFT assumes that, had the buses not run, the cost of insuring the white buses would not have been incurred and so it is considered to be avoidable.
- 7.182 **Fuel** - if the service had not run the fuel expense would not have been incurred, hence the cost is avoidable.
- 7.183 **Restoration costs** were incurred to make the white service vehicles roadworthy, specifically to run on the white services. Unless required for this activity, the work would not have been undertaken. Consequently the OFT concludes that they are avoidable costs.
- 7.184 **Maintenance cost** was incurred on the white services, arising from wear and tear in use⁵²⁰ and was entirely made up of the expense associated with engineering parts. The maintenance cost would not have occurred if the white services had not run, and is thus treated as avoidable.
- 7.185 **Tyres** degrade over time and must be replaced regularly to ensure safety. The wear and tear would not have occurred if the white services had not run and tyre costs would have been avoided.
- 7.186 **Road tax** is a legal requirement and was included by Cardiff Bus as avoidable.⁵²¹ On this basis, the OFT assumes that, had the buses not run, road tax expense would not have been incurred and hence the cost was avoidable.
- 7.187 **Lubricants** are used to ensure the safe and smooth running of engines. If the white service vehicles had not been in service, lubricants would not have been used and can therefore be considered as avoidable.
- 7.188 **Depreciation** represents an estimate of the diminution in the value of the white service buses due to wear and tear. Although the OFT considers this would be an avoidable cost over the relevant period, the buses were

⁵¹⁹ Completed pro forma, submitted on 14 September 2005.

⁵²⁰ Source: Cardiff Bus' Monthly profit and loss account.

⁵²¹ Response to OFT's section 26 notice dated 15 December 2005, question 7 Part C (v).

fully depreciated in accounting terms. As the residual value of the buses would also be low, the depreciation is not considered material for the cost analysis and so it has not been included.

(ii) Allocation methodology

Table 25: White services' avoidable costs over 10 months

Cost category	Allocation basis	Avoidable cost - All white services, sum for relevant period, £	Percentage of total cost
Drivers' Payroll	Driver Hours	[...][C]	[...][C]
Insurance	Miles	[...][C]	[...][C]
Fuel	Miles	[...][C]	[...][C]
Restoration	n/a	[...][C]	[...][C]
Maintenance	Miles	[...][C]	[...][C]
Tyres	Miles	[...][C]	[...][C]
Road Tax	Miles	[...][C]	[...][C]
Lubricants	Miles	[...][C]	[...][C]
Depreciation	n/a	n/a	n/a
Total		[...][C]	100

Source: Cardiff Bus.⁵²²

7.189 **Drivers' payroll** is allocated on the basis of the number of driver hours used by the service,⁵²³ as a change in the frequency of service would inevitably lead to a change in the number of driver-hours required on a route.⁵²⁴

7.190 **Insurance** and **road tax** are required to run a service and the additional white services required taxed and insured vehicles. These costs have been allocated based on miles driven.

⁵²² Response to OFT's section 26 notice, dated 17 August 2006.

⁵²³ Cardiff Bus' submitted pro forma included a record of driver hours for each month on a route-by-route basis. These hours were recorded as part of Cardiff Bus' scheduling system.

⁵²⁴ The OFT notes that Cardiff Bus' significant observation exercise described in Section E of this Chapter may also have entailed additional costs to those identified in the OFT's assessment of costs, to the extent that any observations were made and forms completed outside the 'drivers payroll' hours data supplied by Cardiff Bus.

- 7.191 **Fuel** is allocated on the basis of miles run by the route. The more miles a bus travels the more fuel it will need, and the allocation method reflects this.
- 7.192 **Restoration** cost was calculated by Cardiff Bus for each of the 13 buses with which it initially intended to operate the white services.⁵²⁵ In the event, Cardiff Bus used only 11 of the 13 buses as not enough drivers could be found to use all 13 buses. The cost included is the sum of all restorative costs with the exception of road tax, which was allocated based on miles driven.
- 7.193 **Maintenance** costs are related to the age of a vehicle and the distance driven. Costs have been allocated according to distance driven. This may underestimate costs slightly, as the white services vehicles would probably require more maintenance than the newer vehicles used to provide Cardiff Bus' normal services.
- 7.194 **Tyres'** life will depend on the distance driven, and tyres wear out after a certain number of miles. The tyre cost is allocated on the basis of distance driven.
- 7.195 **Lubricants** are required to keep a vehicle running. Increasing the distance driven will increase the cost of lubricants. These costs have been allocated according to the distance driven.

(e) Revenues included in the analysis

- 7.196 Cardiff Bus has separated its income into two categories: on-bus and off-bus. On-bus revenue includes all money taken on a route by the bus driver, including a small element of overpayment of fares arising from Cardiff Bus' 'no change' policy. Since monies were collected on a per bus basis, accurate revenues are known.
- 7.197 Off-bus revenue is accounted at a level aggregated across routes. Cardiff Bus has provided an estimate of the share of off-bus revenue

⁵²⁵ Response to s26 notice, dated 15 December 2005, question 7 part C (v).

attributed to the white services.⁵²⁶ This is used as an estimate of off-bus revenues that would have been forgone as a result of not running the white service. There are three sources of off-bus revenue:

- Discounted passes: Concession passes and free bus passes (allowing discounted or free passage on some or all services) which are provided by Cardiff Council.
- Revenue generated commercially by the sale of bus passes: There are a variety of different passes that can be purchased, but all revenue from these sources is grouped as multiride revenue in Cardiff Bus' income statements.
- Advertising revenue: Cardiff Bus allocated advertising revenues to the white services from its central resources equivalent to [...] [C] per cent of the total revenues generated by these services.

7.198 Discounted pass and commercial pass income was allocated in proportion to the number of users of a particular pass on the white services, relative to the number of pass users on the entire Cardiff Bus network, which is the level at which the costs are centrally held. The white services used a metro-rider ticket machine to collect the number of users. On a normal service this data is collected by drivers entering fare information into a more sophisticated computer system.

7.199 Cardiff Bus has not provided an explanation for its method of allocating advertising revenue. The amount of revenue attributed to the white service seems to the OFT to be disproportionately high considering that the white services carried no external advertising. Table 26 shows the proportion of on and off-bus revenue allocated to white and normal services by Cardiff Bus, illustrating the high proportion of revenue made up from off-bus revenue for Cardiff Bus' white service ([...] [C] per cent of total revenue compared with [...] [C] per cent for the normal services). Despite its doubts as to the allocation method for advertising used by Cardiff Bus, the OFT has erred on the side of caution by including this revenue as allocated by Cardiff Bus. Were the OFT not to

⁵²⁶ From Cardiff Bus' completed pro forma received on 14 September 2005.

take this conservative approach to the cost analysis and exclude this estimate of advertising income, the revenue for the white services would be £[...][C] lower, or [...][C] per cent of their off-bus income.

Table 26: Proportion of on-bus and off-bus revenue by service, April 2004 to February 2005

Revenue proportions	Normal services		White services	
	£ thousand	Per cent	£ thousand	Per cent
On-bus revenue	[...][C]	[...][C]	[...][C]	[...][C]
Off-bus revenue	[...][C]	[...][C]	[...][C]	[...][C]
Total	[...][C]	100	[...][C]	100
<i>Off-bus revenue is composed of</i>				
<i>Multi Ride</i>	[...][C]	[...][C]	[...][C]	[...][C]
<i>Concessionary</i>	[...][C]	[...][C]	[...][C]	[...][C]
<i>Advertising</i>	[...][C]	[...][C]	[...][C]	[...][C]

Source: Cardiff Bus.⁵²⁷

7.200 Cardiff Bus suggested in its written representations on the SO,⁵²⁸ that the transferability of tickets between normal and white services meant that revenue from the sale of tickets from normal services could not be automatically set against the cost for normal services. This could affect the OFT's analysis if it meant that the revenue for white services was understated. While the OFT recognises that tickets bought on the normal services could be used on white services and vice versa, it does not consider that this leads to an understatement of white service revenue, thereby weakening its analysis, for the reasons set out below.

7.201 In general terms, the transferability of tickets meant that a return ticket bought on the normal service could be used on the white services and vice versa. If more people bought return tickets on normal service and then used a white service to return, than bought a return ticket on a white service and then used a normal service, then it would be

⁵²⁷ Letter responding to OFT's section 26 notice dated 26 May 2005.

⁵²⁸ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 56, paragraph 6.56.

necessary to allocate some of the revenue taken on normal services to white services, in order to avoid under-allocation of revenue to the white services. However, given the greater frequency of the normal services, and the preference apparently shown by some customers for normal services, it is highly likely that there would have been more cases of return tickets bought on a white service being used on a normal service than the reverse. As a result the likelihood is that the transferability of tickets would lead to white service revenue being overstated, not understated. This would be particularly so given the likelihood that the white services might have been expected to lead to some cannibalisation of Cardiff Bus' sales of tickets for its normal services (see paragraphs 7.122 to 7.130), which we have not included in our analysis.

- 7.202 Consequently the OFT concludes that the income allocation used may be generous to the white services and overstate the white service revenue. The transferability of return tickets would therefore not affect the results of the OFT's cost analysis.
- 7.203 Cardiff Bus also suggested in its written representations on the SO,⁵²⁹ that it is not clear to what extent the provision of no-frills services on the routes in question generated additional customers on that route for the normal services given the additional frequency of services on the route overall. This could affect the OFT's analysis if it meant that the incremental revenue for white services was understated, because part of the revenue from the sale of tickets from normal services should be allocated to the revenues for white services.
- 7.204 While the OFT recognises that there is a theoretical possibility that the incremental service frequency due to the introduction of white services may have fed normal services and thus generated additional revenues that would have not otherwise existed, the observation of patronage

⁵²⁹ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007.

levels for normal services both on an annual and on a monthly basis does not show any discernible such effect.⁵³⁰

ii. The results of the costs and revenue analysis

7.205 Part i of this Section set out the scope and methodology of the cost analysis to be applied in this case. The OFT has employed an avoidable cost benchmark, comparing avoidable costs with revenues for the white services over the period of their operation between April 2004 and February 2005. The results of the cost analysis are shown in Table 27 for all the white services.

Table 27: Results of the costs and revenue analysis over 10 months

	All white services
Total revenue	£[...][C]
Avoidable cost	£[...][C]
Contribution (revenue minus avoidable cost)	(£[...][C])
Contribution as a percentage of revenue	(72%)

Source: Figures derived by the OFT from cost data supplied by Cardiff Bus.⁵³¹

7.206 Table 27 shows that revenue from the white services failed to cover the white services' avoidable costs. Revenue was 42 per cent lower than avoidable cost for white services as a whole. Revenue would have had to rise by 72 per cent to equal avoidable costs.

7.207 As restoration costs only amounted to [...][C] per cent of avoidable cost, excluding these costs would not have led to a different conclusion to the analysis.

7.208 Overall, the white services made a negative contribution of £[...][C] for all white services. Revenue of £[...][C] generated by these services was insufficient to cover even drivers' payroll costs of £[...][C].

⁵³⁰ Indeed, the annual patronage level attributable to the 17, 44, 50, 58 and 62 normal routes slightly decreased from the year 2003/04 to 2004/05. This slight reduction in patronage on the normal services on the relevant routes is observed in roughly equal measure both in the months preceding the price increase on normal services in August 2004, and the months following the price increase until the withdrawal of the white services.

⁵³¹ Data taken from response to the OFT's section 26 notice, dated 26 May 2005.

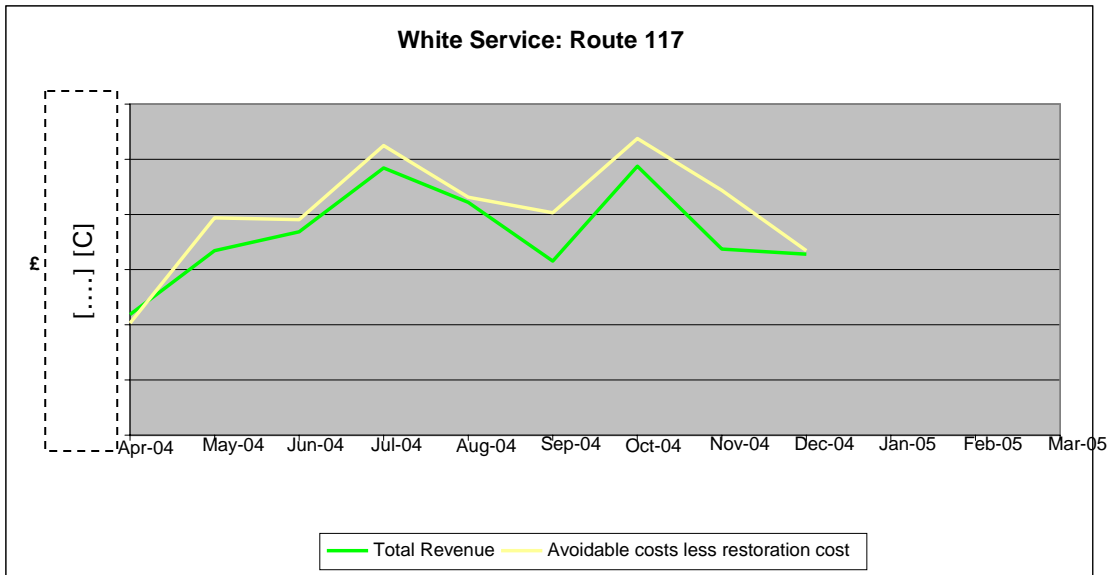
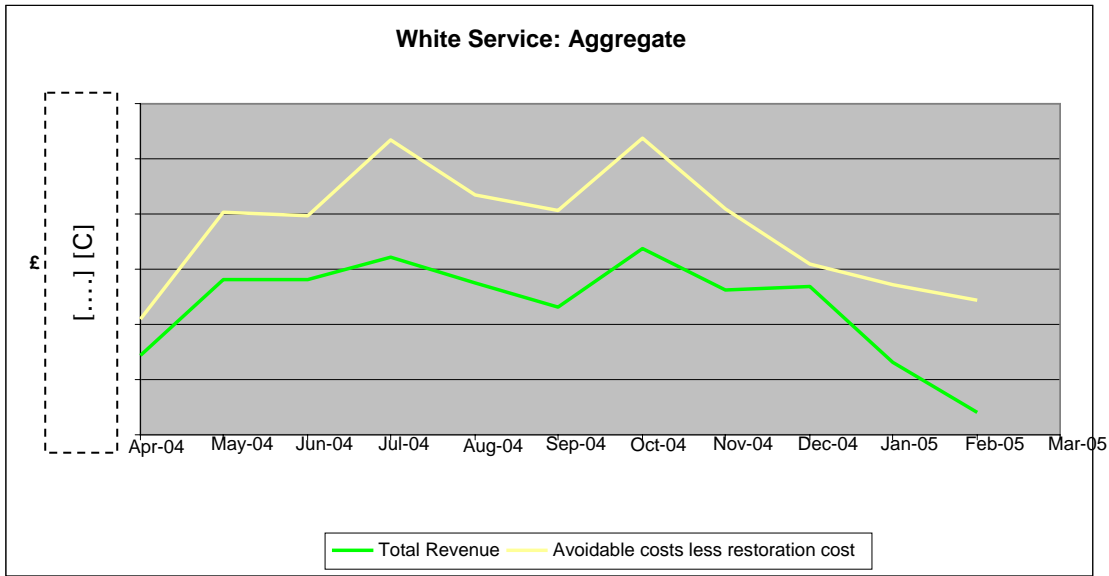
7.209 When considering individual routes, even when restoration costs are excluded, all the routes failed to cover avoidable costs; and avoidable costs exceeded revenue in 47 out of 49 periods. Table 28 sets out the results of the costs analysis for each white service, whilst the graphs in Figure 25 set out the results of the cost analysis by route on a monthly basis. Restoration costs are not included on these monthly graphs because these costs were not allocated to routes by Cardiff Bus. Avoidable costs are consequently slightly understated.

Table 28: Results of the costs and revenue analysis by service⁵³²

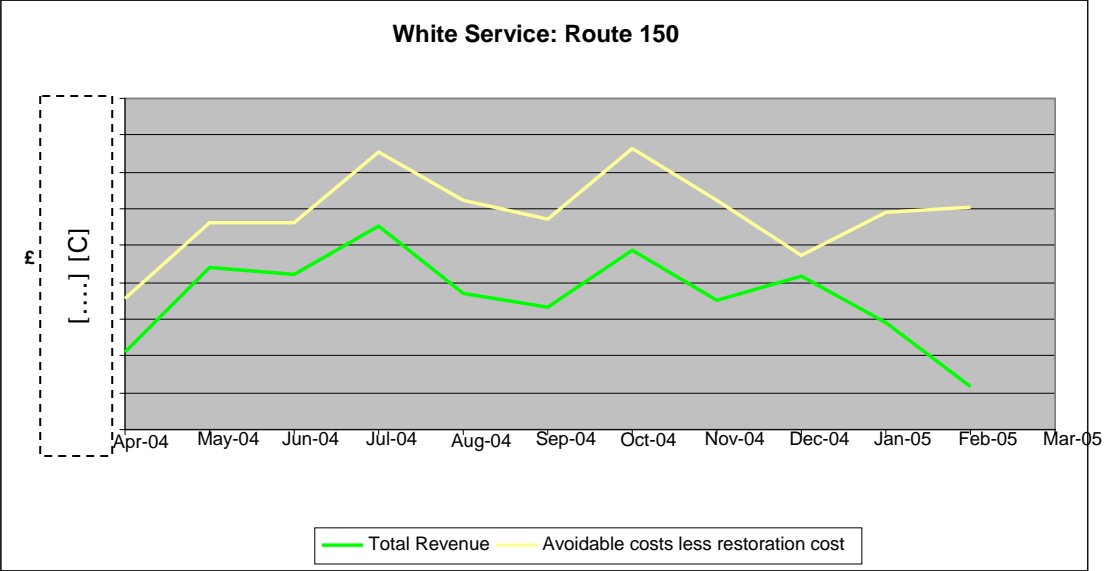
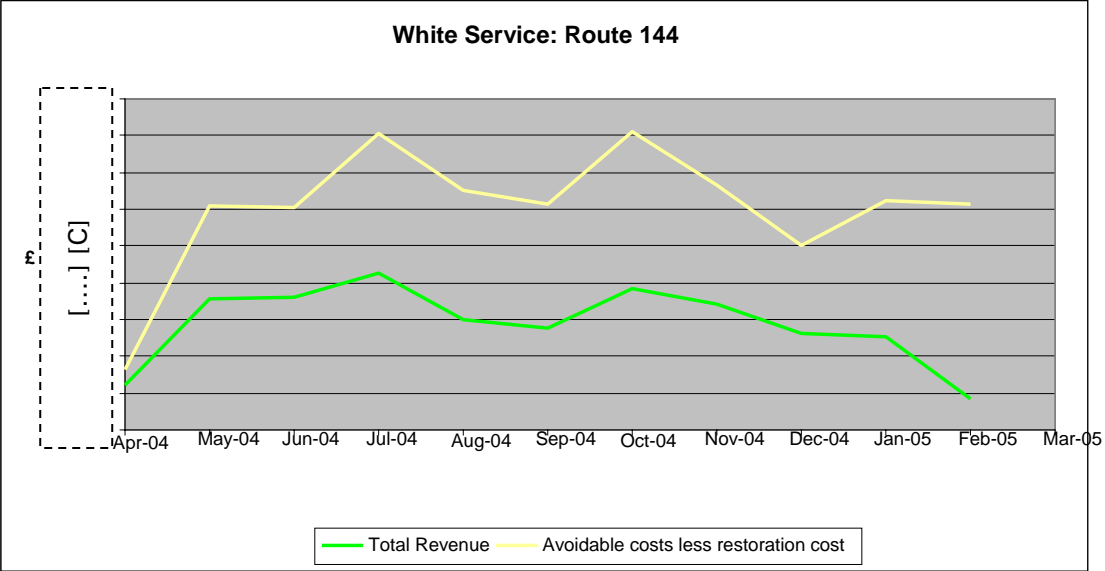
White service	Duration	Total Revenue	Total Avoidable Cost	Contribution (revenue minus avoidable cost)
117	8 months	£[...][C]	£[...][C]	(£[...][C])
144	10 months	£[...][C]	£[...][C]	(£[...][C])
150	10 months	£[...][C]	£[...][C]	(£[...][C])
157/158	6 months	£[...][C]	£[...][C]	(£[...][C])
162	9 months	£[...][C]	£[...][C]	(£[...][C])

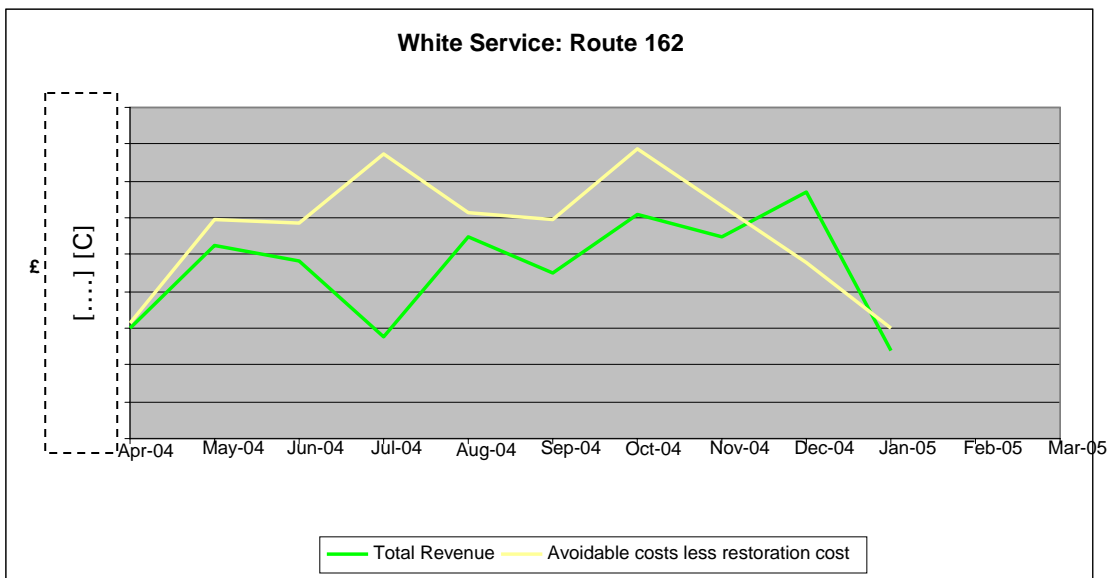
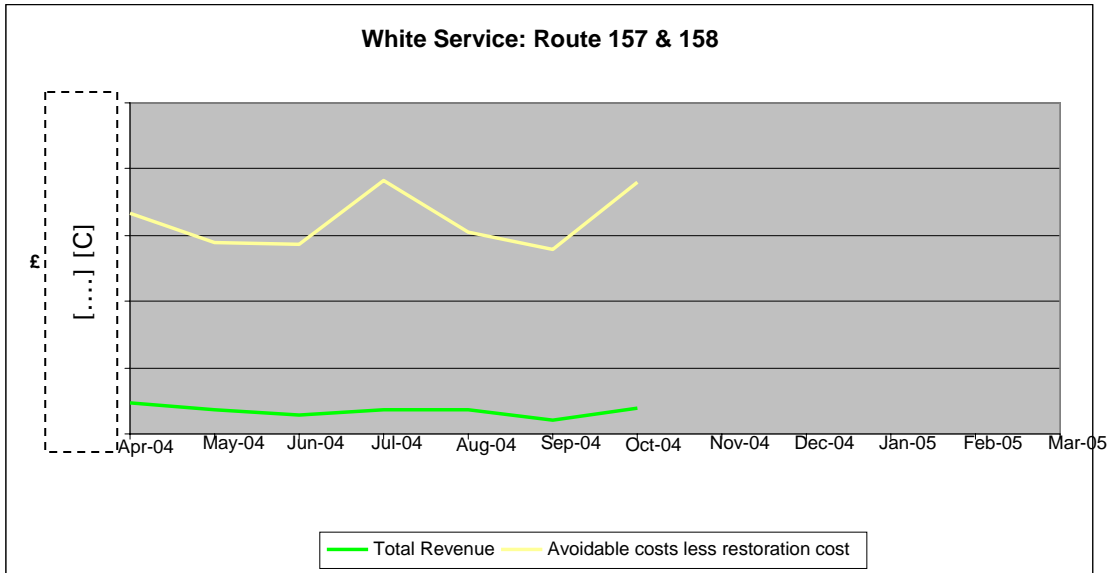
⁵³² Note restoration costs were incurred as a lump sum prior to commencement of the white services and as such are not included in Table 28. This favours Cardiff Bus.

Figure 25: Results of the costs and revenue analysis, by service on a month-by-month basis⁵³³



⁵³³ Note restoration costs were incurred as a lump sum prior to commencement of the white services and as such are not included in the graphs in Figure 25. This favours Cardiff Bus.





7.210 As the white service on route 157/158 was not run in competition with 2 Travel the OFT has also considered the costs and revenue analysis if route 157/158 were excluded. In this case, avoidable costs were £[....][C] higher than revenue.

7.211 Cardiff Bus stated⁵³⁴ that the OFT's costs and revenue analysis should focus on its expectations. To this end, Cardiff Bus provided projections of the revenue that it might have expected to earn from the white services, based on the assumption that passengers boarded the first bus that arrived. However, the OFT notes that these were calculated from the actual combined passenger volumes for normal and white services, and thus are a reworking of historic figures rather than a representation of Cardiff Bus' expectations at the time that it introduced the white services.

7.212 Nevertheless, even if Cardiff Bus' model were to be taken into consideration, it is based on assumptions that, in the OFT's view, overstate the likely level of passengers on the white services. Cardiff Bus estimated passenger volumes based on the number of buses run on each service, but this does not fully take into account the time interval between services, nor that the white services did not run for the same hours during the day as the normal services and in particular, the white services did not run in some peak periods. In the OFT's view, these weaknesses in the underlying assumptions in Cardiff Bus' model mean that the model is not a reliable basis for calculating estimated passenger volumes.

7.213 In its written representations on the SO,⁵³⁵ Cardiff Bus suggested that the period over which the white services were run was not an unreasonable time over which to make an assessment of profitability and points to some of the services being close to being profitable. However, the OFT found that only one service (117) was close to being profitable and another (162) was profitable for one month only.

7.214 As outlined above the white services would have needed to increase revenues by 72 per cent for the service to be profitable. Figure 25

⁵³⁴ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 50, paragraphs 6.2 onwards.

⁵³⁵ Cardiff Bus' written representations on the OFT's SO, dated 7 August 2007, page 62, paragraphs 7.15 to 7.17.

shows no discernable upward trend for the white service which could support a view that the routes would eventually be profitable.

- 7.215 Cardiff Bus also stated in its written representations on the SO that it takes 12 months for a service to attain full profitability.⁵³⁶ If this was Cardiff Bus' intention then it is surprising that it cancelled its white services soon after 2 Travel's exit rather than fully testing their profitability in a market where it no longer faced competition. It should also have been clear to Cardiff Bus that the services were making a loss at an early stage given that, in response to a section 26 notice, Cardiff Bus stated that its performance was measured on a regular basis through the production of management accounts and monthly benchmark statistics.⁵³⁷ It was also the case that Cardiff Bus cancelled the one service that 2 Travel had not competed on two months before it started withdrawing other services.
- 7.216 In its written representations on the SO, Cardiff Bus suggested that the lower prices charged on the white services were justified because the quality of the service was lower; and that it did not lower these prices where they were higher than the equivalent prices charged by 2 Travel. However, neither argument would address the OFT's finding that the prices charged on the white service were insufficient to cover avoidable costs. Furthermore, the OFT notes that the white services' fares were lower than 2 Travel's on three of the four zones.
- 7.217 Cardiff Bus has suggested in its written representations on the SO, that the OFT has not demonstrated that Cardiff Bus intended to set prices at a level that would cause losses, nor suggested that revenue would have been higher if different prices had been charged. However the OFT's conclusion is based on the failure of revenue to cover the defined level of costs over the period over which the white services were run. While it is possible that a loss-making service could be started due to a

⁵³⁶ Cardiff Bus' written representations of 7 August 2007 on the OFT's SO, dated 15 May 2007.

⁵³⁷ Letter to the OFT dated 21 January 2008, responding to the OFT's section 26 notice of 20 December 2007.

miscalculation of the expected return, there was no evidence that Cardiff Bus considered revising or withdrawing the service when losses were being made from the outset and throughout.

7.218 Cardiff Bus also suggested that it was a reasonable assumption that passengers would board the first available bus and that the failure of passenger numbers to provide sufficient revenue to cover avoidable costs was due to an unpredictable passenger response. However, the OFT notes that the white services were run over a 10-month period. Furthermore, if the purpose of the service had been market testing, it would be expected that performance would be regularly reviewed, probably on a monthly basis. Revenue from the white services failed to cover avoidable costs on most months for each route and in aggregate (see paragraphs 7.205 onwards). Even if Cardiff Bus had not intended to incur losses, the OFT considers that the length of time when the loss-making services were run was sufficient for Cardiff Bus to become aware that the services were loss-making and for corrective action to be taken (by, for example, ceasing the service or by actively promoting the service). As noted at paragraphs 7.131 onwards, Cardiff Bus appeared to be aware that demand for no-frills was 'poor' within two weeks of running all its white services.⁵³⁸

7.219 In this respect, the OFT notes that Cardiff Bus, in response to a section 26 notice, stated that its performance is measured on a regular basis through the production of management accounts and monthly benchmark statistics. These are presented by the Executive Directors to the Board at their bi-monthly Board Meetings, with the normal process being one of the Executive Directors explaining the figures to Board members, with variances from expectations being discussed and commented upon.⁵³⁹

⁵³⁸ Cardiff Bus' Managing Director's report to the Cardiff Bus Board, 4 May 2004.

⁵³⁹ Letter to the OFT dated 21 January 2008, responding to the OFT's section 26 notice of 20 December 2007.

7.220 At the oral representations hearing, Cardiff Bus further claimed that the white services were a minor issue for it. David Brown commented:⁵⁴⁰ 'quite simply, I was a new MD seeking to get to grips with a company where there were a lot of issues to address, seeking to develop a business plan for the entire company, which you see pretty much set out a few months later in this document here. That's where my mind was, that's where I was working at the time. And taken in context of what I was trying to do for the company as a whole, you see Cardiff Bus as a company with a turnover of around £25 million at that time, the no frills services were less than [...] per cent of our total turnover. My mind was simply not there, it was here in the bigger picture'.

7.221 However, while the OFT acknowledges that the white services represented a small proportion of Cardiff Bus' turnover at the time, the avoidable losses that Cardiff Bus incurred from running the Services represented nearly [...] of its profits for the year ([...] per cent, or [...] losses compared with profits of £690k for 04/05). Furthermore, the attention given to them by the Board was more substantial than might have been expected from Mr Brown's statement in the oral representations. In particular, 2 Travel and Cardiff Bus' white services were discussed at Board meetings before and during their operation (see paragraphs 7.93 and 7.132).

iii. The OFT's conclusions on the costs and revenue analysis

7.222 The OFT has applied its analysis of costs and revenue to Cardiff Bus' white services, examining total revenue and avoidable cost for the white services as a whole. Overall, even after making some assumptions that are favourable to Cardiff Bus concerning advertising revenue and the basis of cost allocation, the analysis indicates that the white services as a whole, and each of them in isolation, failed to generate sufficient revenue to cover avoidable costs. Revenue was 42 per cent lower than avoidable cost for white services as a whole. Revenue would have had to rise by 72 per cent to equal avoidable costs.

⁵⁴⁰ Transcript of oral representations hearing, 15 October 2007 line 10 page 9.

7.223 This conclusion would not change on the basis of an average variable cost benchmark, as this would only have reduced costs by [...] [C] per cent in this case, by excluding restoration costs.

iv. Overall conclusion on the evidence

7.224 Having carefully considered the evidence in the round presented in Sections E and F, the OFT rejects Cardiff Bus' explanation that it launched its white services as a market test. Cardiff Bus launched a service without considering whether this service would have been profitable and which made a loss throughout the period of its operation.

7.225 The OFT finds that Cardiff Bus acted with exclusionary intent for the purpose of maintaining its existing dominant position by driving out 2 Travel. The OFT concludes that the evidence is sufficient to demonstrate that Cardiff Bus infringed the prohibition imposed by the Chapter II prohibition of the Act, by engaging in predatory conduct which amounted to the abuse of its dominant position in the relevant markets. Cardiff Bus' operation of its white services lasted from 19 April 2004 to 18 February 2005, which is therefore the duration of its predatory conduct.

7.226 Cardiff Bus argued⁵⁴¹ that, given its status as a company founded on public service, any profitability assessment would be flawed. It suggested that Cardiff Bus was run entirely for the benefit of the people of Cardiff, its goals are focused on the provision of socially beneficial services even where margins were minimal, and it was therefore not necessarily profit-maximising.

7.227 In the OFT's view, this does not affect the application of the Chapter II prohibition (see paragraph 3.8). According to European case-law⁵⁴² the fact that an organisation lacks a profit motive or does not have an economic purpose does not disqualify it as an undertaking, provided that

⁵⁴¹ Sources: Letter to the OFT dated 11 July 2005, and Cardiff Bus' brochure *Achieving the vision through partnership 2005-09*.

⁵⁴² See for example Case 209/78 etc *Van Landewyck v Commission* [1980] ECR 3125, [1981] 3 CMLR 134, paragraph 88.

it is carrying on some commercial or economic activity.⁵⁴³ Therefore, even if Cardiff Bus' primary or sole goal is not to maximise profits, it is still subject to the Chapter II prohibition. Furthermore, as a dominant undertaking, Cardiff Bus had (irrespective of its ownership arrangements) a special responsibility not to further impair effective competition.

7.228 Section G now turns to the effects of Cardiff Bus' behaviour on actual competition and potential competition, whilst Section H addresses the issue of recoupment and possible consumer harm from Cardiff Bus' behaviour.

G Effect on competition

7.229 As stated at paragraph 3.3, a dominant undertaking is under a special responsibility not to allow its conduct to impair undistorted competition, including that competition which still remains in the market.⁵⁴⁴ It is only necessary to prove that the abusive conduct of a dominant company carries the risk of eliminating competition on the relevant market;⁵⁴⁵ the conduct is assessed at the time it is committed - if a company in fact does not succeed in eliminating competition, this does not render otherwise abusive conduct lawful.⁵⁴⁶ The OFT considers in any event that Cardiff Bus' conduct carried such a risk, and accordingly it is not necessary in this case to go on to find an actual effect on competition (in the form of elimination of competition) or an actual effect on consumers (through recoupment and higher prices).

⁵⁴³ As noted at paragraph 2.25, Cardiff Bus is a private company which is expected to make a contribution to Cardiff Council by paying it regular dividends.

⁵⁴⁴ *Michelin*, op.cit.

⁵⁴⁵ *Tetra Pak II*, op.cit.

⁵⁴⁶ See for example, T-201/04 *Microsoft v Commission*, at paragraph 561: '...The expressions 'risk of elimination of competition' and 'likely to eliminate competition' are used without distinction by the Community judicature to reflect the same idea, namely that Article 82 EC does not apply only from the time when there is no more, or practically no more, competition on the market. If the Commission were required to wait until competitors were eliminated from the market, or until their elimination was sufficiently imminent, before being able to take action under Article 82 EC, that would clearly run counter to the objective of that provision, which is to maintain undistorted competition in the common market and, in particular, to safeguard the competition that still exists on the relevant market'.

7.230 The OFT nevertheless in the Section below also sets out its analysis of the likely effects on competition flowing from Cardiff Bus' predatory conduct.

i. Effect on actual competition

7.231 2 Travel's no-frills services were only a part of its operation. For instance, in November 2004, its no-frills services represented approximately 25 per cent of 2 Travel's services in Cardiff, with the other approximately 75 per cent of its services being either tendered or school services.⁵⁴⁷

7.232 Furthermore, as detailed in paragraphs 2.40 onwards, the evidence indicates that shortly after the introduction of its four commercial bus services in direct competition with routes served by Cardiff Bus, 2 Travel was investigated by the Traffic Commissioner over concerns about its financial standing as a result of poor service levels in Neath Llanelli, Camarthenshire and Gwent. These problems did not appear to be related to 2 Travel's activities in Cardiff. Moreover, it appears from internal Cardiff Bus documents that Cardiff Bus was aware of the difficulties that 2 Travel had been encountering (see the discussion at paragraphs 7.137 to 7.140).

7.233 Given these developments, it may be the case that 2 Travel might eventually have exited the market even if Cardiff Bus had not engaged in predation against it.

7.234 However, given 2 Travel's weak financial position and its apparent difficulties in providing effective bus services in certain areas, the OFT considers it likely that 2 Travel was at particular risk of being forced to cease its Cardiff operations or prevented from gaining market share so as to become an effective competitor and improve its financial situation. This is particularly so given 2 Travel's strategy to expand its no-frills

⁵⁴⁷ This calculation is based on 2 Travel operating 11 school services, two tendered services and four commercial (no-frills) services. Source: *Complaint by 2 Travel concerning certain activities of Cardiff Bus in Cardiff: A submission to the OFT*, 3 November 2004.

services to a full-timetable, combined with its reliance on external sources of finance.⁵⁴⁸ Moreover, the fact that 2 Travel was experiencing such difficulties does not, in the OFT's view, provide any justification for Cardiff Bus to predate against it.

- 7.235 On this basis, whilst there may be a question as to 2 Travel's long term viability, the OFT considers that it is likely that Cardiff Bus' predatory conduct was a contributory factor in 2 Travel's exit from the market, potentially accelerating its exit. Given how little actual competition Cardiff Bus faced at the time and the fragmented nature of that competition (see Chapter 5), this would have reduced actual competition.
- 7.236 Cardiff Bus argued in its written representations on the SO⁵⁴⁹ that the operation of the white services may have increased the number of no-frills passengers, to the potential benefit of 2 Travel. Given the scheduling of the white services it seems doubtful that this was the case. As explained at paragraphs 7.122 onwards, the costless transferability of the tickets for the white services made them more attractive to bus users, compared to 2 Travel's. Therefore, it is unlikely that the provision of a second no-frills service encouraged increased demand for 2 Travel's no-frills service. Furthermore any advertising of the white services was minimal, thereby restricting any market growth for both Cardiff Bus and 2 Travel.
- 7.237 The OFT also notes in Chapter 6 that Cardiff Bus' actions were consistent with a strategy of frequency incumbency. This strategy seeks to divert potential consumers away from new competitors and is not likely to have generated additional customers for 2 Travel.

⁵⁴⁸ In this respect, the 'signal-jamming' model referred to in footnote 401 can also be applied to an external lender's decision to make or to limit outside financing, where such decisions are sensitive to a firm's short term performance. See Bolton, P. and D. Scharfstein (1990), *A Theory of Predation Based on Agency Problems in Financial Contracting*, *The American Economic Review*, 80 (1), 93 to 106.

⁵⁴⁹ Cardiff Bus' written representations of 7 August 2007 on the OFT's SO, dated 15 May 2007, paragraph 2.10.

- 7.238 In the LECG report attached to its written representations on the SSO,⁵⁵⁰ Cardiff Bus argued that there was no effect given that 2 Travel would have made losses and exited even if Cardiff Bus had not entered with its white services. The OFT notes that the LECG report's estimation of the profitability of 2 Travel, in the counterfactual scenario where Cardiff Bus had not entered with its white services, is based on historical passenger figures. Thus the analysis addresses the question as to whether or not Cardiff Bus' conduct did have any effect, rather than whether it was capable of having that effect, which is the relevant question.
- 7.239 In considering whether Cardiff Bus' conduct was capable of having that effect it is relevant to consider evidence of Cardiff Bus' expectations when it started its white services. There is evidence to suggest that Cardiff Bus expected 2 Travel to generate incremental profits from its entry. For example, a Cardiff Bus press release in April 2004⁵⁵¹ stated: 'That appears to be the whole purpose of the exercise [2 Travel's entry], to provide much needed cash for a company, which last year reported losses of nearly £1m on a £4m turnover'.
- 7.240 Furthermore, LECG state that their analysis indicates that, looked at ex post, 2 Travel would have been unprofitable irrespective of Cardiff Bus' actions as long as 2 Travel's incremental driver costs had been significant.⁵⁵² However 2 Travel were reported in the press as stating that their drivers were being paid during the day, yet between the tendered school services the drivers had little to do absent the commercial services, implying the incremental driver costs of the commercial service were very low.⁵⁵³ Cardiff Bus was apparently aware that 2 Travel was running its services as fill-in services between its tendered services (see paragraph 7.116) and therefore could have inferred that 2 Travel would have been unlikely to incur significant

⁵⁵⁰ LECG report, dated 1 August 2008, Section 2.

⁵⁵¹ Cardiff Bus press release dated 13th April 2004, titled 'Nothing new' offered by limited competitive bus services'.

⁵⁵² LECG argue that if 2 Travel's incremental driver costs had been at least [...] [C] per cent of Cardiff Bus' driver costs, 2 Travel would have made a loss irrespective of Cardiff Bus' actions.

⁵⁵³ 'Bus Wars' – article in South Wales Echo, dated 17th March 2004. See paragraph 7.116.

incremental driver costs in providing its services (in contrast to Cardiff Bus' own white services).

ii. Effect on potential competition

7.241 As discussed in Chapter 6, the OFT's assessment in this case indicates that the market is characterised by high barriers to entry and expansion. Three third parties stated to the OFT that in their view Cardiff Bus had a reputation as an aggressive competitor (see paragraph 6.69). Reputation has also been cited as a barrier to entry and/or expansion in the bus industry. In this regard, the OFT would point to a number of investigations in the coach and bus services sectors which recognise the perception of aggressive competition from incumbent operators and the threat of retaliation as having a deterrent effect on entry by potential competitors.⁵⁵⁴

7.242 Against this background, Cardiff Bus' predatory conduct immediately prior to the eventual exit of 2 Travel from the market would have enhanced its reputation among potential market entrants as an aggressive incumbent, particularly in relation to the introduction of no-frills bus services (see the discussion at Section D of this Chapter).⁵⁵⁵ This would have thereby further strengthened and insulated Cardiff Bus' incumbency and thus increased the likelihood that competitors would be deterred from entering the market to challenge Cardiff Bus' dominant position on a large scale.

⁵⁵⁴ See for example the following CC and MMC reports: *Stagecoach/Scottish CityLink Joint Venture Inquiry, Provisional Findings Report*, 16 August 2006; *Arriva plc and Sovereign Bus & Coach Company Ltd: A report on the acquisition by Arriva plc of Sovereign Bus & Coach Company Ltd*, ISBN 0-11-702725-1, 7 January 2005; *FirstGroup plc and the Scottish Passenger Rail franchise: A report on the proposed acquisition by FirstGroup plc of the Scottish Passenger Rail franchise currently operated by ScotRail Railways Limited*, ISBN 0117022497, 28 June 2004; *Cowie Group Plc and British Bus Group Limited: A report on the merger situation*, Cm 3578, 18 March 1997; *Stagecoach Holdings Plc and Chesterfield Transport (1989) Ltd: A report on the merger situation*, Cm 3086, 18 January 1996; *The supply of bus services in the north-east of England* Cm 2933, 3 August 1995; *Stagecoach Holdings Plc and S B Holdings Limited: A report on the merger situation*, Cm 2845, 27 April 1995.

⁵⁵⁵ Moreover, as discussed in paragraph 7.41, Cardiff Bus' predatory conduct could have signalled that the no-frills service model was unviable, thus deterring other potential competitors from attempting such a model in the future.

7.243 In the OFT's view, therefore, this demonstrates that Cardiff Bus' behaviour is likely to have directly contributed to a further lessening of potential competition in the market to the detriment of bus consumers in Cardiff. The issue of potential competition is also discussed in the next Section in relation to the feasibility that Cardiff Bus could recoup its losses sustained during predation.

iii. Conclusion

7.244 Whilst it may be the case that 2 Travel was experiencing financial difficulties, this does not prevent a finding of predation by Cardiff Bus aimed at eliminating its competitor.

7.245 In this case, some third parties have indicated that they perceived Cardiff Bus as having an aggressive reputation, which was also instrumental to entrenching its dominance (see Chapter 6). The OFT therefore concludes that it is likely that by engaging in predatory conduct, Cardiff Bus will have weakened potential competition in the market to the detriment of bus passengers.

7.246 Moreover, by pre-empting the emergence of no-frills bus services and preventing their possible development at a larger scale, Cardiff Bus is likely to have reduced consumer choice. This may be particularly harmful in this case, given the socio-economic characteristics of the targeted consumers.

H Possibility of recouping losses

7.247 A further consideration that may arise in cases involving alleged predation is whether the dominant undertaking, having successfully forced a competitor out of a market, would have the possibility of recouping its earlier losses.

7.248 In *Tetra Pak II* the European Court held that whenever there is a risk that competitors will be eliminated there is no need to prove the possibility of recoupment. This is because the weakened state of competition on the

market on which the undertaking holds a dominant position will, in principle, ensure that losses are recouped.⁵⁵⁶

7.249 Thus the European Court stated at paragraph 44 of its judgment:⁵⁵⁷

'...Furthermore, it would not be appropriate in the circumstances of the present case, to require in addition proof that Tetra Pak had a chance of recouping its losses. It must be possible to penalise predatory pricing whenever there is a risk that competitors will be eliminated. The Court of First Instance found, at paragraphs 151 and 191 of its judgment, that there was such a risk in that case. The aim pursued which is to maintain undistorted competition, rules out waiting until such a strategy leads to the actual elimination of competitors'.

7.250 In *Aberdeen Journals* (No. 2),⁵⁵⁸ the CAT endorsed the Court's view in Tetra Pak II. At paragraph 443 of its judgment the CAT stated: '...We do not read Mr Fennelly's opinion in *Compagnie Maritime Belge* as throwing any doubt on the Court's judgment in *Tetra Pak II*, at paragraph 44, that there is no need to prove the possibility of recoupment whenever there is a risk that competitors will be eliminated'.

7.251 Accordingly, in the light of the above case-law, the OFT concludes that it is not necessary to prove the possibility to recoup losses in order to find an abuse of predatory conduct in this case.

7.252 However, notwithstanding that the OFT is not obliged to show that Cardiff Bus recouped its losses, in the circumstances of this case, the OFT has investigated whether it is likely that Cardiff Bus would be able to recoup its losses following the exit of 2 Travel. The OFT sets out

⁵⁵⁶ Case C-333/94P *Tetra Pak v Commission* [1996] ECR I-5951.

⁵⁵⁷ *Ibid.*

⁵⁵⁸ *Aberdeen Journals Limited v The Office of Fair Trading* [2003] CAT 11 at paragraphs 441 to 446. Similarly, in Case T-340/03 *France Télécom*, the Court of First Instance considered the previous cases of *AKZO* and *Tetra Pak II*, and held in that case that the European Commission had been correct to take the view that proof of recoupment of losses was not a precondition to making a finding of predatory pricing (paragraphs 224 to 228). This judgment is currently under appeal to the European Court of Justice (Case C-202/07 P *France Télécom SA v Commission of the European Communities*).

below the factors that it considers renders plausible the possibility of recoupment by Cardiff Bus.

- 7.253 There are a number of ways in which a dominant undertaking may be able to recoup losses sustained during its predatory investment. The predator may be able to put in place price increases above the competitive level persisting in the market before the predation. Alternatively, recoupment may be achieved because the dominant undertaking avoids or postpones a decrease in prices that would otherwise have occurred as a result of the introduction of, or an increase in, competition that would have come from the company that the dominant undertaking has disciplined or forced to exit the market. In addition, the dominant undertaking may be able to recoup its losses by establishing or enhancing an existing reputation as an aggressive competitor, with the effect of making future entry less likely in the same market, thereby allowing it to charge higher prices than would otherwise have been the case.
- 7.254 In this case, as noted above in the assessment of dominance in Chapter 6, there are significant barriers to entry and expansion in the market for bus services in Cardiff principally caused by Cardiff Bus' network and frequency incumbency. As explained in Chapter 6, this network and frequency incumbency results from contractual switching and shopping costs; from the costs of entry, due to scale and scope economies, for full-service bus operators; and from Cardiff Bus' existing reputation as an aggressive incumbent versus no-frills bus operators. Moreover, as explained in Section G, Cardiff Bus' predatory conduct toward 2 Travel is likely to have increased its reputation and may have sent a signal that the no-frills model may not be profitable.
- 7.255 The OFT notes that, since November 2003, Cardiff Bus has increased the cost of a Zone 1 adult single ticket by 85 per cent and the cost of a child single ticket by 100 per cent.⁵⁵⁹ The OFT also notes that the TAS

⁵⁵⁹ Source: Cardiff Bus fares booklet, 2 November 2003: Zone 1 Adult single fare was 65 pence; and Zone 1 child single fare was 40 pence. South Wales Echo, March 19 2008: article headed 'Cardiff Bus ups prices to maintain services', which states: '...new charges will take effect from

report commissioned by Cardiff Bus, commented on its daily and weekly tickets, stating: '...The majority of single and return tickets users are not using day tickets because they do not feel that purchase is financially worthwhile',⁵⁶⁰ and '...The majority of cash fare payers see no financial benefit in using a weekly ticket.'⁵⁶¹ The TAS report also noted: '...that the Multiride range of tickets are relatively expensive compared to seasonal tickets in other UK cities that have a similar population to Cardiff.'^{562, 563}

7.256 In particular, the OFT notes that following 2 Travel's exit from the market, Cardiff Bus has increased its fares by approximately 40 per cent.⁵⁶⁴ As further evidence of Cardiff Bus' independence from competition, it is informative to benchmark Cardiff Bus' fare increases against the industry averages. Figure 26 compares Cardiff Bus' fare indices with the indices for Wales and Great Britain.

April 6 and mean the cost of an adult single ticket in the city will rise from £1 to £1.20 while a child's single ticket will rise from 70p to 80p'. See: <http://icwales.icnetwork.co.uk/news/cardiff-news/2008/03/19/cardiff-bus-ups-prices-to-maintain-services-91466-20646496/>.

⁵⁶⁰ The TAS report, paragraph 2.2.8.

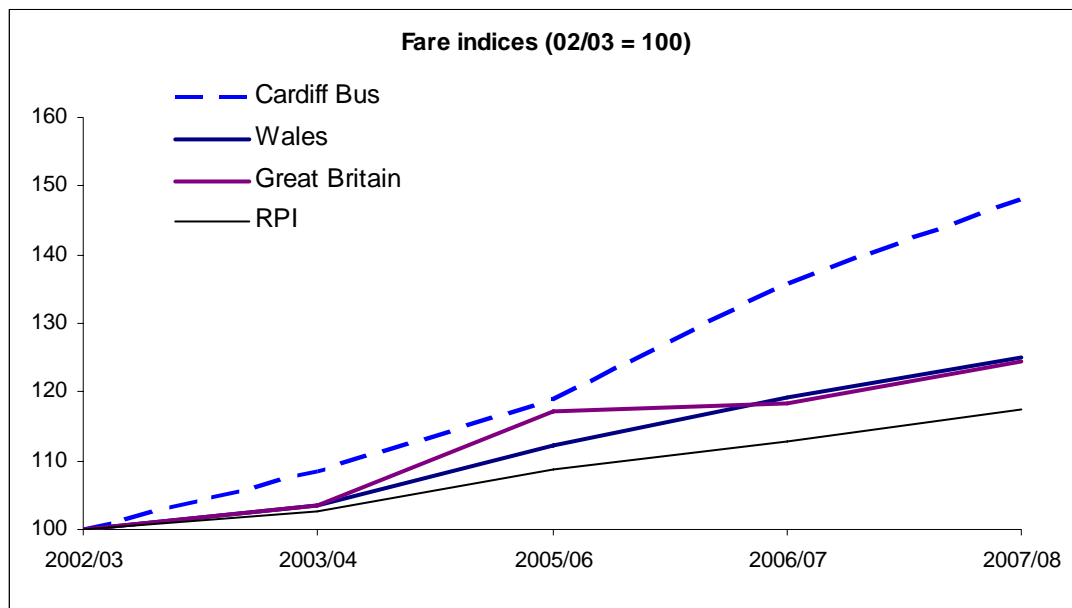
⁵⁶¹ Ibid, paragraph 2.2.9.

⁵⁶² Ibid, paragraph 4.3.1.

⁵⁶³ These statements also suggest that Cardiff Bus' cash fares are at least comparable to equivalent tickets in other UK cities with a similar population.

⁵⁶⁴ This figure corresponds to the arithmetic average of its Adult fares' increases from August 2004 to April 2008, which equates to an average yearly compounded increase of nine per cent.

Figure 26: Local bus fare indices, 2002/03 to 2007/08



Source:

Source: OFT calculations based on Cardiff Bus' data⁵⁶⁵ and DfT's Transport Statistics GB 2008 report (September 2008).

7.257 Following 2 Travel's exit from the market, Cardiff Bus may therefore have benefited by being able to continue to operate to a greater extent independently of any effective competitive constraint on its behaviour. In particular, as noted in Chapter 6, Cardiff Bus' ability to modify the relative attractiveness of network tickets is a powerful lever against potential FSO competitors. The most profitable way to increase local network effects could be by increasing single fares, rather than by reducing the price of network tickets.

⁵⁶⁵ The curve for Cardiff Bus represents the arithmetic average of its Adult fares. Sources: Cardiff Bus' fares booklets and <http://www.cardiffbus.com/fares.shtml>.

8 THE OFT'S PROPOSED ACTION

8.1 This Chapter sets out the action the OFT will take and its reasons for taking that action.

A Finding of infringement

8.2 The OFT finds on the basis of the strong and compelling evidence set out and analysed above that during the period of the infringement (19 April 2004 to 18 February 2005), Cardiff Bus was dominant in the relevant markets and abused its dominant position by engaging in predation against 2 Travel. The OFT is therefore satisfied that Cardiff Bus has infringed the Chapter II prohibition.

B Directions

8.3 Undertakings must by law comply with the Chapter II prohibition. Section 33(1) of the Act provides that if the OFT has made a decision that conduct infringes the Chapter II prohibition, it may give to such person or persons as it considers appropriate such directions as it considers appropriate to bring the infringement to an end.

8.4 On the information currently available to it, the OFT does not consider that the predatory conduct carried out by Cardiff Bus during the period identified in paragraph 8.2 above is ongoing. The OFT is not therefore issuing directions in this case.

C Penalties

8.5 Section 36(2) of the Act provides that, on making a decision that conduct has infringed the Chapter II prohibition, the OFT may require the undertaking concerned to pay it a penalty in respect of the infringement. No penalty which has been fixed by the OFT may exceed 10 per cent of the turnover of the undertaking calculated in accordance with the provisions of the Competition Act 1998 (Determination of Turnover for Penalties) Order 2000 (SI 2000/309), as amended by the Competition Act

1998 (Determination of Turnover for Penalties) (Amendment) Order 2004 (SI 2004/1259).⁵⁶⁶

- 8.6 Sections 40(3) and (4) of the Act provide that a person is immune from the effect of section 36(2) if his conduct is conduct of minor significance. The OFT may withdraw that immunity if as a result of its investigation the OFT considers that the conduct is likely to infringe the Chapter II prohibition. Conduct of minor significance is defined, pursuant to section 40(1) of the Act and Regulation 4 of the Competition Act 1998 (Small Agreements and Conduct of Minor Significance) Regulations 2000 (the Regulations),⁵⁶⁷ as conduct by an undertaking the applicable turnover of which for the business year ending in the calendar year preceding the one during which the infringement occurred does not exceed £50 million.
- 8.7 Applying the provisions of the Regulations and, through section 60 of the Act, applying the meaning of the term 'undertaking' under EC law, the OFT considers that the applicable turnover of Cardiff Bus does not exceed £50 million. Accordingly, Cardiff Bus benefits from immunity provided for in section 40(3) of the Act. The OFT can decide to withdraw the immunity from financial penalties in circumstances where it considers that it would be appropriate to do so. The OFT does not propose to do so in this case. The OFT does not therefore impose a penalty on Cardiff Bus for the infringement set out at paragraph 8.2 above.

Heather Clayton on behalf of the OFT

Senior Director, Infrastructure and Knowledge Economy

⁵⁶⁶ Section 36(8) of the Act and SI 2000/309.

⁵⁶⁷ SI 2000/262.

Annexe 1

Flow-by-flow analysis methodology

Introduction

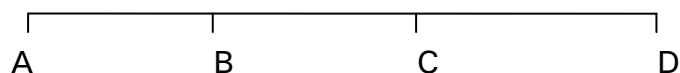
1. This Annexe provides additional detail regarding the assumptions and methodology underpinning the flow-by-flow analysis set out in Chapter 5 of the Decision. It contains three Sections:
 - **Section A:** One of the key assumptions of the analysis was to examine the share of supply of bus services on only the shortest flows, that is, the journeys between adjacent bus stops, rather than on all possible flows between stops. Section A explains why this decision was made.
 - **Section B:** Chapter 5 of the Decision provides a brief overview of the methodology and the assumptions used for the analysis. Section B sets out in detail the steps taken and assumptions made for both the flow-by-flow analysis and the city centre analysis.
 - **Section C:** For simplicity, the flow diagrams presented in Chapter 5 of the Decision labelled each of the stops on a route alphabetically rather than by stop name. Section C contains a series of summary tables which match the letter used in the corresponding route diagram with the name/location of the bus stop.

Section A

2. This Section begins with a brief review of the basic concepts underpinning the flow-by-flow analysis of an urban bus route.
3. As explained in Chapter 4 of the Decision, each possible journey between two stops on a route is a 'flow'. In general, there will be $N \times [N - 1]$ flows on any given route, where N is the number of stops. Thus, in Figure 1 below, flows include journeys AB, BC, CD, AD and all other

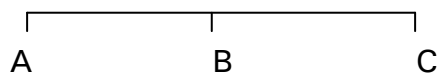
combinations, with a total of 12 flows. Throughout the analysis, a journey between adjacent bus stops, such as AB, is referred to as a 'short' flow, and a long journey between two bus stops containing one or more intermediate stops, such as AC (where the intermediate stop is bus stop B), is referred to as a 'long' flow.

Figure 1



4. The flow-by-flow analysis undertaken for this case considers the share of supply of Cardiff Bus and the other bus and urban rail operators present on the relevant flows at the time (see Chapter 4 for the market definition). This analysis forms part of the OFT's overall assessment of dominance.
5. As the example above shows, on any urban bus route there will be a large number of potential flows. Undertaking an analysis of the share of supply held by Cardiff Bus on every flow would be onerous and extremely resource intensive. Therefore, rather than examining all flows, the analysis focuses only on the short flows. The long flows on the route will be an aggregation of different combinations of these short flows. Therefore, establishing that Cardiff Bus is dominant on each of these shortest flows will also establish that it will be dominant on any longer flow on the five routes, since the extent of competition faced by Cardiff Bus on a longer flow would be no lower than on any of these smaller flows. This analysis is robust providing that third party bus services on long flows stop at all the bus stops within that flow.
6. The following simple hypothetical example explains this in more detail:

Figure 2



7. The route in Figure 2 has three bus stops, A, B, and C. In this example, buses travel in the direction from A towards C. The route has three flows, AB, BC and AC.

Services operating on route

8. The following services operate on the route:
- Cardiff Bus
 - 15 services per day, covering flows AB, BC and AC.
 - Stagecoach:
 - Five services covering flows AB, BC and AC.
9. Figure 3 shows the share of supply of Cardiff Bus services for the three flows on the example route.

Figure 3

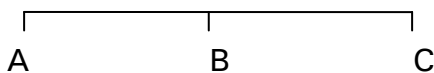
Services	AB	BC	AC
<i>Cardiff Bus</i>	15	15	15
<i>Stagecoach</i>	5	5	5
Cardiff Bus share (percent)	75	75	75

10. On the long flow AC, Cardiff Bus has a share of supply of 75 per cent. Within this long flow are two shorter flows, AB and BC. On these shorter flows, Cardiff Bus also has a share of supply equal to 75 per cent. Because the share of supply on the long flow AC is no lower than any of the small flows of which it is comprised, there is no reason to consider the longer flow.

Exceptions to the rule

11. The example above suggests that there is no need to consider the Cardiff Bus share of supply on any of the longer flows. However, this assumes that third party bus services, when travelling along a long flow do not miss out any stops along the way.
12. In the example above, Stagecoach services began at stop A, stopped at stop B, before travelling onto stop C. These services are therefore present on flows AB, BC and AC.

Figure 4



13. However, consider the following example in which Stagecoach services begin at stop A and travel to stop C, missing out stop B. The services therefore operate only on flow AC. Figure 5 below shows the share of supply of services on each of the flows modified to take into account this change.

Figure 5

Services	AB	BC	AC
<i>CB</i>	15	15	15
<i>Stagecoach</i>	0	0	5
Cardiff Bus share (percent)	100	100	75

14. With Stagecoach services missing out stop B, the Cardiff Bus share of supply on the longer flow AC (75 per cent) is lower than the share of supply on the shorter flows AB and BC (both 100 per cent). In cases such as this, it is necessary to consider the share of supply on the relevant longer flows.
15. This scenario occurred only once on the routes in question, between stops A (Newport Road 1) and C (Newport Road 2) on the 150 route. In this particular case, Stagecoach services X3 and X16, and Newport Travel service 30D, travelled along an alternative route between stops A and C. On this flow Cardiff Bus had a share of supply exceeding 80 per cent.

Cardiff Bus services missing out stops

16. On parts of the five white service routes, a number of normal Cardiff Bus services missed out stops along the route. This implies that the Cardiff Bus share of supply on the short flows is likely to be lower than on some of the longer flows. However, the analysis has not been adjusted to take

account of this, partly for simplicity, and also because it is favourable towards Cardiff Bus.

Conclusion

17. The examples above justify the methodology used by the OFT in looking at only the smallest flows between adjacent bus stops rather than each and every flow on a route. In the instance where third party services missed out a stop, further investigation of the relevant flow took place.

Section B

18. The parts of the routes outside the centre of the city were assessed on a flow-by-flow basis. The city centre was analysed separately, and was assessed as a whole, rather than being broken down into its constituent flows. This reflects the greater potential for demand side switching due to the presence of a large number of stops close together, and the less detailed information available on the services offered within the city centre. This Section begins with a detailed description of the methodology used to assess the share of supply on flows on each route, excluding the city centre.

Detailed methodology of the flow-by-flow analysis on the remainder of the route

19. The analytical steps taken in the flow-by-flow analysis were as follows:
 - i) The OFT used the white service timetable to identify and plot the five white service routes on the *Cardiff Bus, Rail and Tourist Map & Guide 2003* (the map).
 - ii) Having established the routes, the map was used to identify all of the bus stops and the services calling at these stops on each route.
 - iii) From this, it was possible to determine the bus services travelling between adjacent bus stops (flows).

- iv) To take into account the fact that some buses used alternative roads when travelling away from the city centre to those when travelling towards the city centre, the analysis considered outward and return legs separately for each route. A second reason for doing this is because it is likely that a passenger is going to be travelling to a destination point on either the outward or inward bound leg of the route. For example, a bus passenger may travel from their home to the city centre to shop and then return home via the same or different bus service. The service and route taken may therefore differ, but the origin and destination points are the same.
- v) The previous step established which Cardiff Bus normal services and third party services operated on each flow. The next step used the map key to calculate the total daily frequency of these services on a flow-by-flow basis. These figures rest on the following assumptions:
- They only include services running between 08:00 and 17:30. These hours were used as bounds for the frequencies because the exact start and finish times for services varied by route and company. The source data did not specify the actual start and finish times for each specific route so a set time period was used to ensure that the calculation compares bus service operators in a period in which they would definitely be offering bus services.
 - When calculating the daily frequency of each bus service, the value obtained was not always a whole number. In these cases, the frequency was rounded down to the nearest whole number. This ensured that only those services that could complete the entire route in the specified time period were included in the frequency analysis.
 - As actual start and finish times varied even more at the weekend, the analysis was confined to weekdays only.
 - Some services were listed as operating at 'peak only'. In these cases, further clarification was sought from the timetable. Two

Cardiff Bus peak only services were included: the X46, with two journeys per day on the outward leg of the route, and four journeys per day on the return leg, and the X59 with similar frequency. One other Cardiff Bus service operated at peak only (the X90), but this was excluded from the analysis because no timetable was available.

- There were also two third party services operating at peak only, the X78 (run by Stagecoach) which according to its section 26 response, operated one morning service per day and the X7 (run by Shamrock Travel), which has been excluded from the analysis because of the lack of a timetable/service schedule.
- Where the frequency varied across different parts of the route in question, the frequency was recorded as the maximum frequency. For example, if the timetable listed '20/40 minutes' as the frequency, this indicated that buses ran every 20 minutes up to a certain stopping point on the route and then only every 40 minutes from this stopping point onwards. For these cases the frequency was taken to be 20 minutes.
- Where a third party service was listed as operating in partnership with Cardiff Bus, the service was assumed to be run solely by the third party. This favours Cardiff Bus in the calculation of market shares.

vi) The next step was to include the frequency of the white and 2 Travel services (which were not included on the map) on each of the relevant flows. In order to calculate these frequencies, the OFT used timetables of the services provided by Cardiff Bus and 2 Travel.⁵⁶⁸ However, these timetables do not include all of the bus stops on each of the routes (that is, they do not show all of the bus stops taken from the map that form the basis of the flow-

⁵⁶⁸ It is important to note that the Traffic Commissioner reported that 2 Travel failed to operate all of its listed services. The OFT's inclusion of all timetabled services therefore favours Cardiff Bus.

by-flow analysis). It was therefore necessary to make additional assumptions to determine the frequency of the white and 2 Travel services on each individual flow. In particular:

- That white and 2 Travel services stopped at all of the bus stops listed on the map on its route.
 - The frequency of bus services serving the whole route was also the frequency serving each of the individual flows.
 - For the 158 service, Cardiff Bus did not provide a timetable. The OFT therefore assumed that the number of white services in operation was the same as the projected number of 2 Travel 258 services (the corresponding no-frills service).
 - In addition, those services listed as operating only on non-school days were excluded from the analysis.
 - On parts of a route with more than one white or 2 Travel service, any overlap on particular flows was included. For example, the 144 and 150 services overlapped near the city centre.
- vii) Having determined the frequency of bus services provided by all operators between each of the bus stops on the five relevant routes, it was possible to calculate the share of supply of services run by each of the operators on a flow-by-flow basis.
- viii) The next step examined the share of supply of bus services from the first to last stop on the outward and return journeys of each route. This showed the extent of competition faced by Cardiff Bus on the longest journey made by any one individual on each route.

Urban Rail services

20. In addition to this, the relevant market definition required that any urban rail services overlapping on the relevant routes needed to be considered.

The analysis assumes that the frequency of one rail service is equivalent to the frequency of one bus service. There are two relevant flows where urban rail was assessed:

- The flows are between the city centre and stop D and then from stop N back to the city centre on the 162 route.
- On the outward leg of the route (between the city centre and D) Cardiff Bus had a share of supply of 67 per cent, and on the return leg (from stop N to the city centre) its share of supply was equal to 68 per cent.

Methodology of the city centre analysis

21. Within the city centre area there are a large number of stops concentrated close together. Previous CC reports have stated that where bus stops are close enough together such that passengers are able to walk between stops, the relevant market is a catchment area, rather than a series of individual flows.⁵⁶⁹ In the city centre area, the stops are so close together that they may act as substitutes for one another. The OFT therefore treated the city centre area as a single flow.
22. The analysis first considered the frequency of services stopping at Cardiff Central Bus Station. This is consistent with the approach used to assess the remainder of the route.

⁵⁶⁹ *Acquisition by Arriva plc of Sovereign Bus and Coach Company Ltd*, Competition Commission, January 2005, Annexe F.

Section C

23. The tables below specify the location of each of the bus stops on the five white service routes.

117 flows

Stop reference	Stops on the route
A	Cowbridge Road East 1
B	Cowbridge Road East 2
C	Cowbridge Road East 3
D	Cowbridge Road West 1
E	Amroth Road
F	Bishopston Road
G	Heol Trelai 1
H	Heol Trelai 2
I	Heol Trelai 3
J	Green Farm Road 1
K	Green Farm Road 2
L	Grand Avenue 1
M	Grand Avenue 2
N	Cowbridge Road West 2
O	Cowbridge Road East 4
P	Cowbridge Road East 5
Q	Cowbridge Road East 6

162 flows

Stop reference	Stops on the route
A	Cowbridge Road East 1
B	Cowbridge Road East 2
C	Cowbridge Road East 3
D	Western Avenue
E	St Fagans Road/Fairwater Green
F	Plasmawr Road 1
G	Pentrebane Road 1
H	Beechley Drive 1
I	Firs Avenue
J	Beechley Drive 2
K	Pentrebane Road 2
L	Plasmawr Road 2
M	St Fagans Road/Fairwater Green 2
N	Western Avenue
O	Cowbridge Road East 4
P	Cowbridge Road East 5
Q	Cowbridge Road East 6

150 flows

Stop reference	Stops on the route
A	Newport Road 1
B	Broadway
C	Newport Road 2
D	Newport Road 3
E	Newport Road 4
F	Llanrumney Avenue 1
G	Ball Road 1
H	Ball Road 2
I	Burnham Avenue 1
J	Countisbury Avenue 1
K	Llanrumney Library
L	Countisbury Avenue 2
M	Burnham Avenue 2
N	Ball Road 3
O	Ball Road 4
P	Llanrumney Avenue 2
Q	Newport Road 5
R	Newport Road 6
S	Newport Road 7
T	Newport Road 8
U	Newport Road 9

158 flows

Stop reference	Stops on the route
A	West Grove/Richmond Road 1
B	Albany Road 1
C	Wellfield Road 1
D	Pen-y-lan Road 1
E	Llanedeyrn Road 1
F	Llanedeyrn Drive 1
G	Pentwyn Drive 1
H	Bryn Celyn Road 1
I	Pentwyn Road 1
J	Pentwyn Road 2
K	Pentwyn Road 3
L	Glyn Coed Road
M	Llanedeyrn Drive 2
N	Llanedeyrn Road 2
O	Pen-y-lan Road 2
P	Wellfield Road 2
Q	Albany Road 2
R	West Grove/Richmond Road 2

144 flows

Stop reference	Stops on the route
A	Newport Road 1
B	Newport Road 2
C	Newport Road 3
D	Newport Road 4
E	New Road 1
F	Greenway Road 1
G	Greenway Road 2
H	Aberdaron Road
I	Hendre Road
J	Crickhowell Road 1
K	Willowbrook Drive 1
L	Willowbrook Drive 2
M	Willowbrook Drive 3
N	Crickhowell Road 2
O	Crickhowell Road 3
P	Crickhowell Road 4
Q	Hendre Road 2
R	Aberdaron Road 2
S	Greenway Road 3
T	Greenway Road 4
U	New Road 2
V	Newport Road 5
W	Newport Road 6
X	Newport Road 7
Y	Newport Road 8

Annexe 2

Supply side substitution

Introduction

1. As discussed in Chapter 4 of the Decision, the OFT believes in this case that supply side constraints are most appropriately considered when analysing potential entry. Consequently Sections D, E and F in Chapter 6 provide a detailed assessment of supply side constraints.
2. However, as a cross-check, the OFT has also considered the implications for the definition of the relevant market of taking into account supply side substitution. This Annexe sets out the OFT's approach, the results of its analysis and consideration of Cardiff Bus' comments on the analysis.

Possible supply side substitution

3. In its recent judgment in the *Chester v Arriva* case,⁵⁷⁰ the High Court considered the extent to which bus operators might be able to substitute their services onto routes in Chester city centre (in other words, supply side substitution). *Chester v Arriva* also highlighted the importance of depot location as a factor in determining the potential for supply side substitution. In particular, the cost of supplying services rises as the distance increases between the bus operator's depot and the start of the bus route, the so-called 'dead mileage'.⁵⁷¹ In that case, the time spent 'dead running' a bus to and from a depot and the route was considered to be the critical factor in determining whether a bus operator could economically serve that route. Consequently, supply side substitution onto routes serving Chester city centre was only considered

⁵⁷⁰ See *Chester City Council v Arriva* EWHC 1373, 15 June 2007, paragraph 159.

⁵⁷¹ 'Dead mileage' refers to the distance travelled from the depot to the start of the route. 'Dead running' refers to the need to drive the bus from a depot to the start of its route.

to be feasible for operators with depots within a reasonable 'dead running' time of the city centre.

4. The approach in the *Chester v Arriva* case provides a relevant starting point for the discussion below.⁵⁷² However, a full analysis of the possibilities for supply side substitution also requires an assessment of whether it is likely that bus operators would indeed engage in supply side substitution from depots identified as feasible. The evidence presented in Chapter 6 from operators such as [...] [C], [...] [C] and [...] [C] demonstrates that even where a depot may appear to be within a feasible distance to provide bus services the bus operator may have little or no intention of providing such services.

(a) The importance of depot location

5. The CC's previous reports have concluded that bus operators can provide services within five to 10 miles of their depot in urban areas and 15 to 20 miles in rural areas.⁵⁷³ This would suggest that only bus operators with depots within 10 miles of Cardiff Central Bus Station should be included as part of an analysis of the potential for supply side substitution on a network basis. The OFT has taken this into account in this Decision, together with both the comments it has received from third parties and the High Court ruling in the *Chester v Arriva* case.

⁵⁷² As discussed in Chapter 4, the key question in assessing the likelihood of supply side substitution is whether, in response to a small but significant increase in price on a route or across a network, a bus operator not currently operating on that route or on the network would switch to supplying bus services on that route or network. See the Commission Notice on the definition of relevant market for the purposes of Community competition law, OJ 1997 C372/5, paragraph 20: 'Supply-side substitution may also be taken into account when defining markets in those situations in which its effects are equivalent to those of demand substitution in terms of effectiveness and immediacy. This requires that suppliers be able to switch production to the relevant products and market them in the short term without incurring significant additional costs or risks in response to small and permanent changes in relative prices. When these conditions are met, the additional production that is put on the market will have a disciplinary effect on the competitive behaviour of the companies involved. Such an impact in terms of effectiveness and immediacy is equivalent to the demand substitution effect'. (It appears from the judgment in *Chester v Arriva* that the *likelihood* of supply side substitution, as distinct from the feasibility of running existing services from existing depots, was not an issue that was raised by the parties in that case.)

⁵⁷³ First Bus and SB Holdings Limited: a report on the merger situation, 1997.

6. As noted above, *Chester v Arriva* highlighted that the cost of supplying services rises as the distance increases between the bus operator's depot and the start of the bus route - the 'dead mileage'. While depots in more remote locations may in principle be able to provide some limited services into Cardiff city centre, it would be costly to do so, given the amount of dead mileage that is potentially involved travelling to and from the registered route, fuel costs and the higher costs of servicing breakdowns off site. This is important because a potential entrant will need to win a certain amount of business to remain viable and the higher the costs will be to compete for passengers, the less likely they are to take such risks.
7. In *Chester v Arriva*, an isochrone was drawn around Chester city centre, to represent locations 30 minutes drive time from Chester central bus exchange. Supply side substitution was then considered to be possible for any bus operators with depots situated inside the 30-minute isochrone.⁵⁷⁴ Thirty minutes was regarded as the maximum 'dead running' time from which a bus depot could economically provide local bus services in Chester itself. The High Court accepted the 30-minute isochrone as an appropriate way of identifying the geographic market, noting that neither of the expert witnesses who had given evidence before it had suggested that the relevant dead run drivetime was more than approximately 30 minutes.⁵⁷⁵
8. In its representations on the SSO,⁵⁷⁶ Cardiff Bus argued that operators would be unlikely to incur a dead run time of 30 minutes from a depot beyond (but adjacent to) the edge of the isochrone, because they could start on a route towards the outskirts of Cardiff in the morning and finish the route at the same point in the evening. However, as explained above, such a remote depot location would limit the potential for supply

⁵⁷⁴ The OFT considers that depot availability in this case represents a theoretical potential to supply the market with bus services, rather than necessarily the ability to do so - the difference being the extent to which the potential to supply can viably be realised in the face of the entry barriers described in Chapter 6.

⁵⁷⁵ See *Chester City Council v Arriva* EWHC 1373, 15 June 2007, paragraph 161.

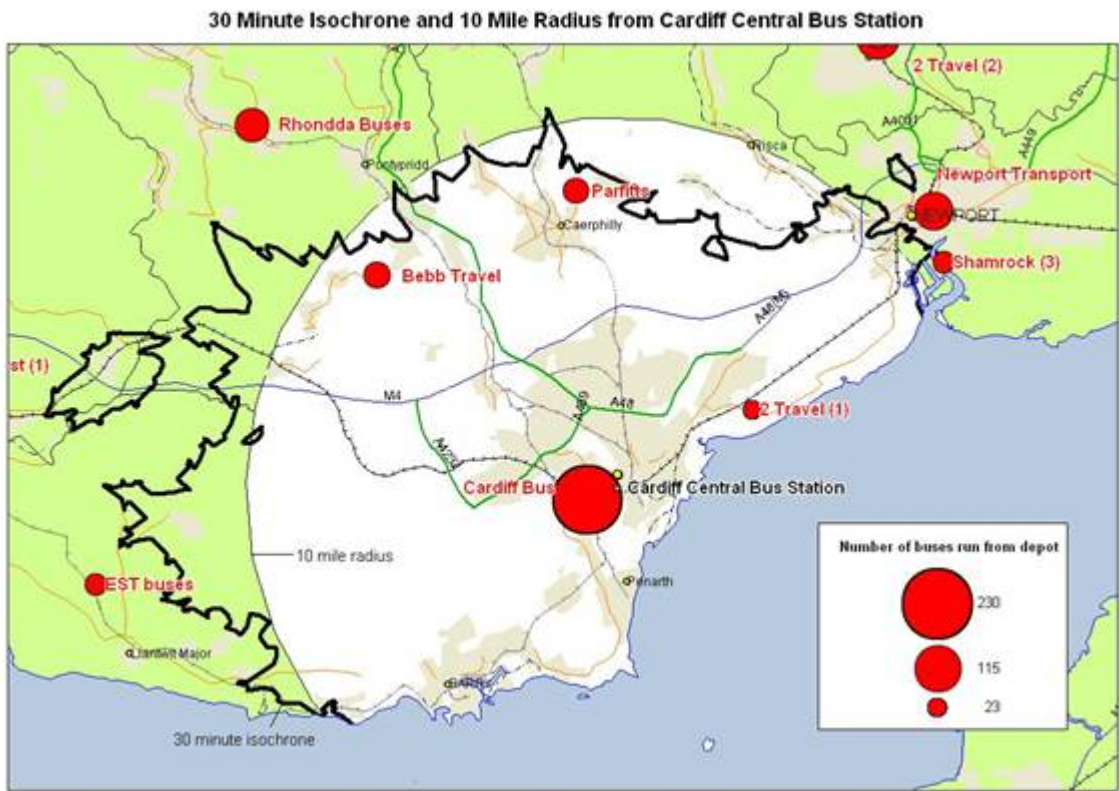
⁵⁷⁶ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, at paragraph 4.24.

side substitution from that depot to those corridors nearest to it, which would be unlikely for the reasons set out in Sections D, E and F of Chapter 6.

(b) Isochrone analysis

9. To assess whether a 30-minute isochrone would be appropriate for an analysis in this case, the OFT compared a 10-mile radius to a 30-minute isochrone, using Cardiff Central Bus Station as the focal point for both boundaries. Because all of the relevant routes described in Section C of Chapter 4 converge on Cardiff Central Bus Station, this is the most relevant focal point from which to assess supply side substitution on a network basis.
10. The results are shown in Figure 1. As can be seen, the boundaries are very similar and importantly, the same depots are included within the 10-mile radius (the lighter shaded area) and the 30-minute isochrone boundaries (the jagged black line). It is therefore reasonable to use a 30-minute isochrone to define the relevant supply side market in this case.

Figure 1: Comparison of bus operators' depots within 10-mile radius and 30-minute isochrone of Cardiff city centre



11. In the *Chester v Arriva* case, neither expert sought to draw a distinction between tendered and commercial services. The OFT considers that it is doubtful that tendered services could be easily switched to provide commercial services. However, to err on the side of caution and for completeness, the OFT has included tendered services in its consideration of supply side substitution in Chapter 5 and this Annex.

(c) Cardiff Bus' response to the OFT's isochrone analysis

12. In its written representations on the SSO, Cardiff Bus raised a number of issues in relation to the OFT's isochrone analysis.

13. The first issue related to the OFT's use of Cardiff Central Bus Station as the focal point for the analysis. In particular, Cardiff Bus stated⁵⁷⁷ that: '...Passenger flows are into Cardiff in the morning and out of Cardiff in the evening. Therefore any operator thinking of expanding, or entering into Cardiff would start on a route in the outskirts of Cardiff in the morning and finish the route at the same point in the evening. It is therefore unlikely that any operator would have to incur anything like a dead run time of 30 minutes from a depot adjacent to Cardiff'. By centring the isochrone analysis on the central bus station, Cardiff Bus suggested that the OFT's analysis was guaranteed to underestimate the potential for supply side substitution from operators with depots in the surrounding area.
14. The OFT rejects this argument. Whilst it might be possible for bus operators considering entry on just a single route, the correct analysis in this case focuses on entry on a network basis (for the reasons explained in Chapter 6). For an operator to switch supply in competition with Cardiff Bus on a network basis, they would require a depot located within a reasonable drivetime of the central bus station.
15. Cardiff Bus also commented⁵⁷⁸ that the 10-mile radius considered by the OFT in its analysis (see paragraphs 5 to 11 of this Annexe) was too conservative. Cardiff Bus cited a Monopolies and Mergers Commission report⁵⁷⁹ which stated: '...It is commonly thought in the bus industry that the maximum range of bus services from its depot is 15 to 20 miles in rural areas and 5 to 10 miles in urban areas'. Cardiff Bus argued that a 15-mile radius would be more appropriate in this case because the '...areas in which depots of those operators surrounding Cardiff are located are more akin to rural than urban areas'.
16. The OFT also rejects this argument for the following reasons:

⁵⁷⁷ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 4.24.

⁵⁷⁸ Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 4.12.

⁵⁷⁹ *First Bus and SB Holdings Limited*: a report on the merger situation, 1997.

- During a meeting with the OFT, First indicated that there were '...a fair number of bus companies operating in and around Cardiff, but that most provided services into the city from outlying areas, rather than servicing the urban market'.⁵⁸⁰ The isochrone analysis is concerned with the possibility of operators with surrounding depots switching bus services into this urban market. The OFT considers that it is unlikely that the areas most likely to be served by buses within the 10-mile radius surrounding Cardiff Central Bus Station would be considered by bus operators as anything other than primarily an urban market and there is thus no basis for widening the radius to 15 miles.
- By identifying a 10-mile radius around Cardiff Central Bus Station, the OFT has, in any case included bus depots that are over 10 miles away when measured in terms of distance travelled on the road. For example, the Bebb Travel depot in Pontypridd and the Parfitts depot in Bedwas are 12 and 13 miles respectively from the central bus station, when measured in terms of actual miles travelled on the road. Therefore, based on the suggestion in the MMC report, the 10-mile radius is unlikely to be considered conservative. If anything, by including the Bebb Travel and Parfitts depots, the OFT takes an approach which favours Cardiff Bus.
- The primary boundary to the market is not the 10-mile radius but rather a 30-minute isochrone. The 30-minute isochrone calculates drivetimes based on, among other things, the speed assigned to different roads. These speeds will vary according to whether the road is in a rural or urban area. Therefore the 30-minute isochrone has already taken into account the extent to which the surrounding area is either rural or urban.

⁵⁸⁰ Agreed note of a meeting on 3 August 2006, paragraph 21.

17. Cardiff Bus also suggested that the OFT had not considered fully evidence' from several operators, and in particular, [...][C], which did not support restricting the operating radius of a depot to just 10 miles.⁵⁸¹
18. However, although third parties did not specifically comment on the distance they could viably operate services from their depots, the OFT has no reason to consider that the conclusion in the CC report, that bus operators in urban areas can only reasonably provide services within five to 10 miles of their depot, is not valid in this case.
19. Furthermore, as discussed in Chapters 4 and 5, the third parties in this case predominantly focused on providing tendered and interurban services. In [...][C] case, in a meeting with the OFT,⁵⁸² [...][C] stated that it operated mostly interurban services and although it had not ruled out competing in Cardiff, the biggest barrier was lack of suitable premises. The implication being, that none of its current depots were sufficiently close to Cardiff to offer a competitive suburban (rather than an interurban) service.
20. [...][C] went on to say⁵⁸³ that it could not operate a suburban service in Cardiff from outside of Cardiff due to the additional costs it would necessarily have to incur. The key additional costs being driver, fuel and breakdown costs. [...][C] also confirmed, with reference to its largest depot in [...][C], that while it might be possible to run a suburban service within Cardiff, in practice it would not be desirable to do so.
21. Given [...][C] comments and those of other third parties already considered (see above) there is no reason for the OFT to change its view that a 10-mile radius around the central bus station provides a useful guide as to whether a 30-minute isochrone is appropriate in this case.

⁵⁸¹ Cardiff Bus' written representations on the OFT's SSO, dated 1 August, paragraph 4.15.

⁵⁸² [...][C]

⁵⁸³ Ibid.

The OFT's analysis of market shares based on isochrones

22. In *Chester v Arriva* the High Court stated the view that the metric (or method of measurement) chosen to assess market shares, should depend on the characteristics of the defined market. In contrast to revenue measures or passenger numbers, a capacity metric was chosen as it best reflected market power in a market when considering the potential for supply side substitution.⁵⁸⁴
23. Given that the issue was how easily bus operators could move or expand onto new routes servicing the city centre, the most appropriate metric was considered to be the number of buses operated from depots falling within the relevant market.
24. In order to calculate market shares on the basis of capacity metrics, the OFT has adopted an approach in line with *Chester v Arriva*, and has computed market shares based on the number of buses operators have at depots inside a 30-minute isochrone of Cardiff city centre.⁵⁸⁵ The market shares are shown in Table 1 and a map showing the locations of depots in Figure 2.⁵⁸⁶
25. The OFT notes, however, that this metric does not identify only the operators who are actually competing with Cardiff Bus, whether on particular routes or even in respect of Cardiff Bus' network as a whole. Rather, the metric provides an indication as to which bus operators have depots in sufficiently close proximity to the heart of Cardiff Bus' network (Cardiff Central Bus Station) that they would not be prevented, by insufficient proximity, from switching capacity so as to compete directly with Cardiff Bus. As explained in Chapter 5, Cardiff Bus has faced very little actual competition on its routes from other bus operators. Further, as noted at paragraphs 6.78 to 6.80, in November

⁵⁸⁴ *Chester City Council v Arriva* EWHC 1373, 15 June 2007, paragraph 180.

⁵⁸⁵ *Chester City Council v Arriva* EWHC 1373, 15 June 2007, paragraphs 175 and 193.

⁵⁸⁶ The OFT's method makes no distinction between buses of different sizes. For example, 20-seat buses are considered to be equal to 40-seat buses for the purpose of analysing market shares. This conservative approach may favour Cardiff Bus, which is likely to have a higher proportion of large buses than would smaller local operators.

2004 Cardiff Bus' Board of Directors did not perceive the company as likely to face any actual competition over a following period of five years.

Figure 2: Depots of bus operators inside the 30-minute isochrone⁵⁸⁷

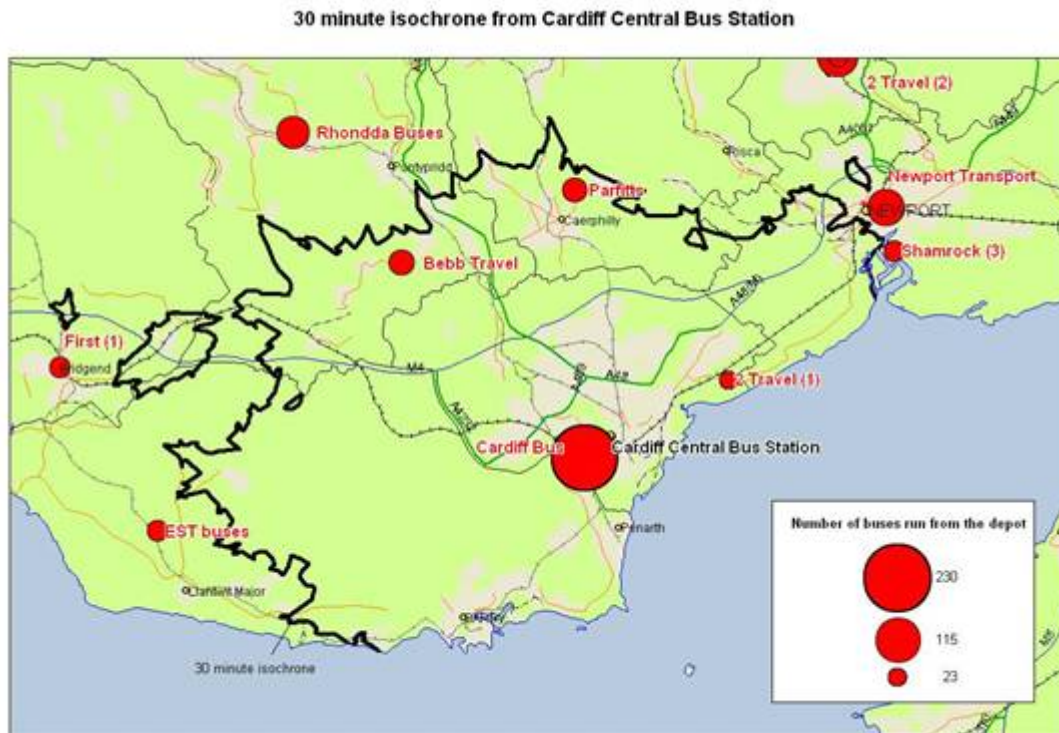


Table 1: Market shares based on the 30-minute isochrone

Bus Operator	Depot location	Number of buses	Market share (%)
Cardiff Bus	Sloper Road	223	69
Bebb	Pontypridd	41	13
Parfitts	Bedwas	38	12
2 Travel	Wentloog Road	20	6

26. As explained in paragraph 10 above, as well as being consistent with the approach in *Chester v Arriva*, the 30-minute isochrone closely matches the boundary representing the 10-mile radius.

⁵⁸⁷ Isochrones were calculated using MapInfo.

27. However, to assess the sensitivity of these results to the size of isochrone chosen, the OFT also calculated market shares based on 25- and 35-minute isochrones. The results are shown below in Tables 2 and 3, as well as Figures 3 and 4.

Figure 3: Depots of bus operators inside the 25-minute isochrone

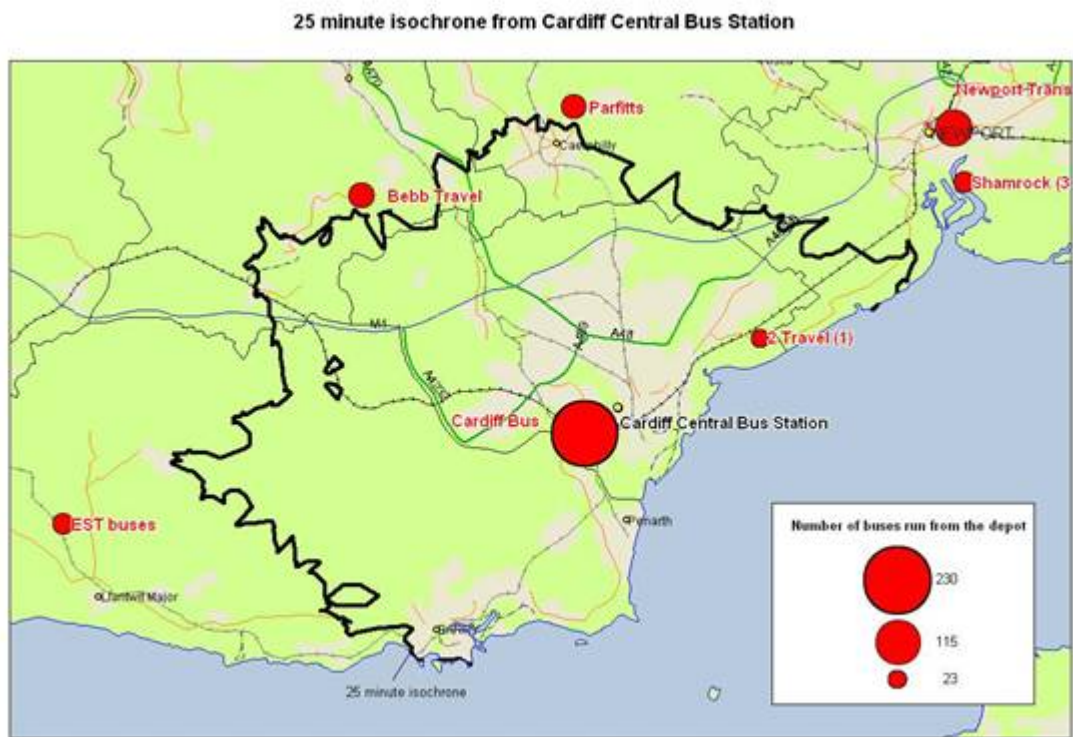


Table 2: Market shares based on 25-minute isochrone

Bus Operator	Depot location	Number of buses	Market share (%)
Cardiff Bus	Sloper Road	223	92
2 Travel	Wentloog Road	20	8

Figure 4: Depots of bus operators inside the 35-minute isochrone

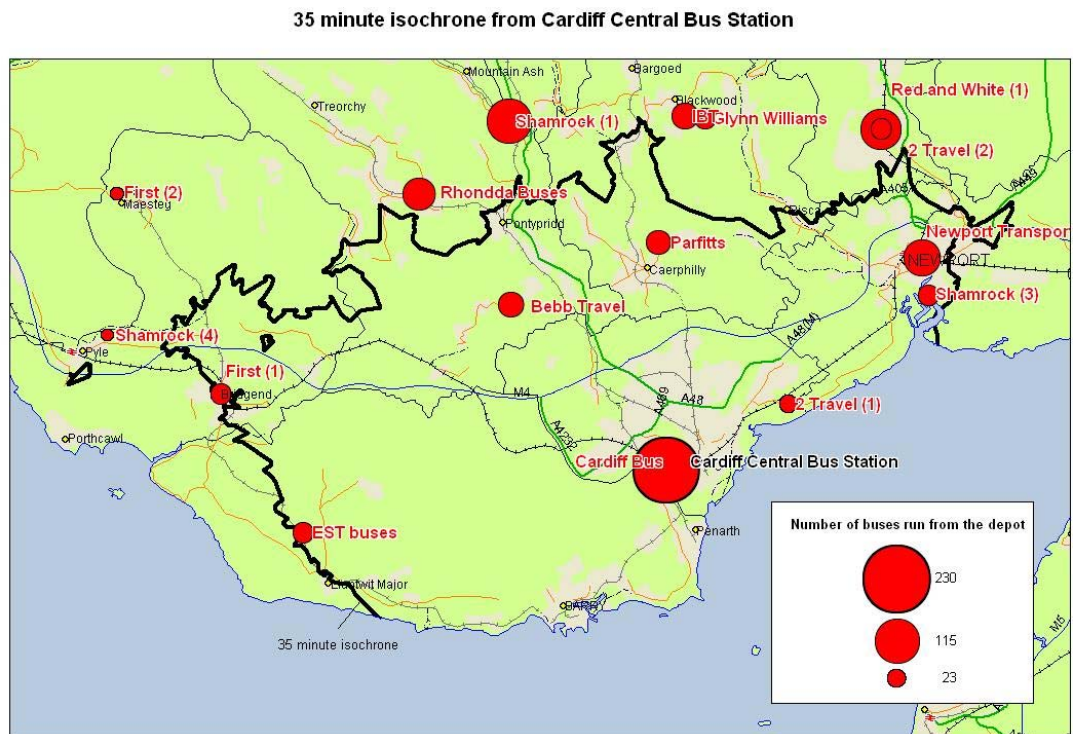


Table 3: Market shares based on 35-minute isochrone⁵⁸⁸

Bus Operator	Depot location	Number of buses	Market share (%)
Cardiff Bus	Sloper Road	223	46
Newport Transport	Newport	80	17
Bebb	Pontypridd	41	9
Parfitts	Bedwas	38	8
EST Buses	Cowbridge	28	6
First	Bridgend	26	5
Shamrock	Newport	25	5
2 Travel	Wentlog Road	20	4

⁵⁸⁸ In the 35-minute isochrone analysis it is worth noting that the decrease in Cardiff Bus' market share can mainly be attributed to the inclusion of Newport Transport's depot. Newport Transport is wholly owned by Newport City Council and primarily serves the city of Newport. However, for completeness, the Newport depot has been left in as part of the sensitivity analysis.

Cardiff Bus' isochrone analysis

28. There is no universally accepted methodology for the calculation of isochrones. The estimates of drivetimes are affected by different assumptions concerning average travel speeds in different areas, the modelling of road junction delays, the underlying road network,⁵⁸⁹ as well as various other factors. Consequently drivetimes and isochrones may vary according to the software package used.
29. For example, Cardiff Bus calculated its own estimate of a 30-minute isochrone around Cardiff Central Bus Station using the AA Route Planner website. By inputting the postcodes for Cardiff Central Bus Station and the postcodes for the surrounding depots Cardiff Bus identified those depots within 30 minutes drivetime of the central bus station. The results are shown below in Table 4.

Table 4: Cardiff Bus' calculation of market shares based on a 30-minute isochrone⁵⁹⁰

Bus Operator	Depot location	Number of buses	Market share (%)
Cardiff Bus	Sloper Road	223	37
Shamrock	Pontcynon	110	23
Shamrock	Newport	25	
Newport Transport	Newport	80	13
Rhonda Buses	Porth	62	10
Bebb	Pontypridd	41	7
Parfitts	Bedwas	38	6
2 Travel	Wentloog Road	20	3

⁵⁸⁹ The area covered by an isochrone also depends on the granularity of the digitized map that the software uses. For example, mapping software that only has major roads will necessarily generate wider isochrones than mapping software that also has very minor roads.

⁵⁹⁰ See Cardiff Bus' written representations on the OFT's SSO, 1 August, paragraph 4.27.

30. As can be seen above, the analysis gives Cardiff Bus a market share of 37 per cent.⁵⁹¹ This is substantially lower than the 69 per cent found in the OFT's own analysis. The discrepancy arises primarily from the inclusion of Shamrock Travel's Pontcynon depot and Newport Transport's depot in the Cardiff Bus analysis.
31. As a check on whether the inclusion of these depots is appropriate, the OFT requested drivetimes from the central bus station to the Pontcynon depot using the Department for Transport's Transport Direct website.⁵⁹² As well as specifying a start and end point for the journey, this software package allows the user to stipulate the date and time of the journey. This enables the final drivetime calculations to take account of other factors, such as whether the journey is during rush hour.
32. For example, the drivetimes for a car from Shamrock Travel's Pontcynon depot to Cardiff Central Bus Station are:⁵⁹³
- 48 minutes on Friday 24 October 2008, leaving at 09:00
 - 32 minutes on Friday 24 October 2008, leaving at 22:00
33. The OFT also notes that Cardiff Bus' 30-minute isochrone includes Newport Transport's single depot. However, according to Transport Direct, the drive times for a car from Newport Transport's depot to Cardiff Central Bus Station are:⁵⁹⁴

⁵⁹¹ As well as a 30-minute isochrone, Cardiff Bus also performed a sensitivity check on their results using a 25-minute and 35-minute isochrone. Taking an average across all three isochrones, Cardiff Bus had a market share of 48.6 per cent. See Cardiff Bus' written representations on the OFT's SSO, 1 August, paragraph 4.27.

⁵⁹² Transportdirect.com is non-profit service funded by the UK DfT, the Welsh Assembly Government and the Scottish Government.

⁵⁹³ Drivetimes from Shamrock Travel's Pontcynon Depot, Pontcynon Industrial Estate, Abercynon, Mountain Ash, Rhondda Cynon Taf (CF45 4EP) to Cardiff Central Bus Station, Wood St, Cardiff (CF10). Results are the quickest journey for a medium-sized petrol engine car. Source: Transport Direct results downloaded on 23 October 2008.

⁵⁹⁴ Drivetimes from Newport Transport's depot at 160 Corporation Road, Newport (NP19 0WF) to Cardiff Central Bus Station, Wood St, Cardiff (CF10). Results are the quickest journey for a medium-sized petrol engine car. Source: Transport Direct results downloaded on 23 October 2008.

- 46 minutes on Friday 24 October 2008, leaving at 09:00
- 31 minutes on Friday 24 October 2008, leaving at 22:00

34. These results suggest Shamrock Travel's Pontcynon depot and Newport Transport's depot should be excluded from the market share calculations based on a 30-minute isochrone.

35. In its response to the OFT's Further Notice, Cardiff Bus claimed⁵⁹⁵ that '...operators would not seek to run dead mileage into or out of the city centre at rush hour, which is the basis for the calculations set out in the Further Notice'. Cardiff Bus further claimed⁵⁹⁶ that using Transport Direct, '...the journey time outside rush hour from Shamrock Travel's Pontcynon depot to Cardiff Central Bus Station is exactly 30 minutes. The journey time from Newport Transport's Depot is 28 minutes'.

36. The OFT rejects this claim as incorrect. Transport Direct drivetime results show that:

- only if a car travels from Shamrock's Pontcynon depot to Cardiff Central Bus Station between midnight and 05:35 is it possible to complete the journey in 30 minutes. At all other times, the journey takes more than 30 minutes. By 06:00 the journey by car takes 39 minutes. At 14:00 (which is not rush hour), the journey by car takes 46 minutes. According to Transport Direct the first bus that can be used for this journey (the X6) leaves at 06:34.⁵⁹⁷ The first bus that enables the reverse journey (Cardiff to Shamrock's Pontcynon depot) leaves at 06:48.⁵⁹⁸

⁵⁹⁵ Cardiff Bus' response to the OFT's Further Notice, dated 10 November 2008, paragraphs 20 to 21.

⁵⁹⁶ Ibid.

⁵⁹⁷ Drivetimes from Shamrock Travel's Pontcynon Depot, Pontcynon Industrial Estate, Abercynon, Mountain Ash, Rhondda Cynon Taf (CF45 4EP) to Cardiff Central Bus Station, Wood St, Cardiff (CF10). Results are the quickest journey for a medium-sized petrol engine car. Source: Transport Direct results downloaded on 13 November 2008.

⁵⁹⁸ Although in this case, the traveller would need to walk to Philharmonic, and also change buses at Pontypridd.

- only if a car travels from Newport Transport's depot to Cardiff Central Bus Station between midnight and 05.35 is it possible to complete the journey in under 30 minutes. At all other times, the journey takes more than 30 minutes. By 06:00 the journey by car takes 38 minutes. At 14:00 (which is not rush hour), the journey by car takes 45 minutes. According to Transport Direct the first bus that can be used for this journey (the 30) leaves from Newport Police Station at 06:33.⁵⁹⁹ The earliest equivalent reverse journey (Cardiff to Newport Transport depot) requires the traveller to take a coach (the 202) which leaves at 06:35.

37. Moreover, the OFT notes that these drivetime results are for a medium-sized petrol engine car. The OFT considers it very likely that a bus would take longer than a car to make the journeys.

38. These results also indicate the sensitivity of isochrone analysis to the choice of software package, as well as how other factors, such as time of day and route chosen, can mean that a depot on the very far edge of a market can fall into or out of the analysis, with potentially significant results for market shares.

39. In any event, it is important to note, in relation to Cardiff Bus' market share calculations provided in Table 4 above, that [...] [C] stated that it had not considered expanding its operations in Cardiff in the past five years (see paragraph 6.29) and that there were significant obstacles to expansion.⁶⁰⁰ [...] [C] also stated that it was deterred from expanding in

⁵⁹⁹ Drivetimes from Newport Transport's depot at 160 Corporation Road, Newport (NP19 0WF) to Cardiff Central Bus Station, Wood St, Cardiff (CF10). Results are the quickest journey for a medium-sized petrol engine car. Source: Transport Direct results downloaded on 13 November 2008. The number 43 bus runs from 06:29, but only to take the traveller to Newport Railway station from where they can catch a train to Cardiff Central Railway Station.

⁶⁰⁰ In its response to the SSO (Cardiff Bus' written representations on the OFT's SSO, dated 1 August 2008, paragraph 4.26), Cardiff Bus stated in relation to its isochrone analysis that: 'These figures include [...] [C] on the basis that there is nothing to prohibit [...] [C] from operating in Cardiff and it does in fact do so'. However, the OFT also notes that [...] [C], commenting on whether there were 'any significant obstacles' to expanding suburban, interurban or network services within the Cardiff county boundary, stated that: 'There are constraints within the 1985 Transport Act which impede our expansion, and also we would be constrained by a lack of commercial viability'. Source: [...] [C].

Cardiff as a result of Cardiff Bus' reputation and ability to respond quickly (see paragraph 6.69). Thus, even if, as a matter of principle, the inclusion of depots within an isochrone analysis is sensitive to the software package used and assumptions about travel speeds, in this case, on the facts available, the OFT's conclusion on Cardiff Bus' dominance within the relevant markets is unaffected by such sensitivities as exist.

40. Finally, it is also important to note that market shares are not in themselves determinative of dominance (see paragraph 5.5). The identified features of Cardiff Bus' position as a bus operator in Cardiff (discussed in Chapters 4 to 6) are, in the OFT's view, such as, when taken together, to strongly indicate dominance.