

ARRIVA/NORTHERN RAIL MERGER INQUIRY

Summary of hearing with Urban Transport Group on 23 June 2016

Background

1. Urban Transport Group (UTG) (2016) was formerly called Passenger Transport Executive Group (PTEG).
2. PTEG had previous experience of working with OFT on the local bus market investigation, the two reviews of ticketing block exemptions, and the rail policy project.

General

3. UTG provided an outline of the UTG's role and constituent members, while also describing the structure of the various emerging transport bodies in England, including Rail North and Transport for the North.
4. UTG had a clear urban city region focus. UTG told us they were active in commuter and regional rail due to legal powers devolved to local transport authorities from the 1960s.
5. UTG clarified that Rail North and Transport for the North comprised UTG members who were within the geographic jurisdiction.
6. UTG said that Rail North, a partnership between the Department for Transport and the Association of Rail North Authorities, was the franchising body for the Northern and Trans-Pennine Express franchises.
7. UTG said that there were plans, being developed by central and local government, for Transport for the North to take greater control over rail investment decisions.

Involvement with the Northern Franchise specification

8. UTG was an advocate on the franchise specification, and made the case for investment. UTG provided technical analysis for the Rail North demand and revenue model that informed Rail North and Department of Transport (DfT) negotiations.

Market Definition

9. UTG said that a considerable proportion of city region passengers use travel cards: multi-modal/multi-operator, or rail-only season tickets.
10. Networks had evolved slowly and many people still associated the PTE brands with bus and train services.
11. UTG said they had specifically looked at market definition in the Rail North demand and revenue model. Northern was largely a commuter network not an intercity service. Most people therefore used it frequently and tended not to seek advance tickets on specific trains, and rather walk up to the first train available.
12. UTG were unsure to what extent there would be resistance to fare increases, although they considered service quality would influence passenger's willingness to pay more.
13. UTG said that since 2004 UTG had campaigned against the assumption of no growth in the previous franchise award, and for improved service quality.
14. UTG referred to information UTG had given to the Competition Commission's local bus market inquiry on market definition. People wanted to turn up and get on the bus or train, so scope for price competition is limited. Structural limitations make on-street or direct competition difficult and undesirable.
15. UTG considered bus and rail services were complementary. Rail services were often faster at linking specific origins and destinations. Rail was the most competitive mode if you lived near the railway station but bus generally offers more comprehensive coverage and therefore becomes more competitive if you did not.
16. UTG said that because of the complementarity between bus and rail networks, integration between modes was important if public transport was to offer a competitive service.
17. UTG maintained that public transport competes with the car for some of the market. City region transport authorities had tried to make pricing more competitive, and insisted on simple ticketing systems across travel to work areas.
18. The Competition Commission (in its 2011 local bus market inquiry) concluded that greater prevalence of multi-operator ticketing would favour a more competitive market.

19. UTG said any new bus entrants needed to increase service frequency up to a level that would not be profitable for either incumbent or new entrant. The two operators would battle it out until one retreated and service frequencies went back down to the pre-competition level.
20. UTG said the bus-rail angle was more complicated to analyse. However, where rail was cheaper to operate and offers a higher quality service, it was clearly difficult for a bus operator to compete.
21. UTG considered bus-bus and bus-rail competition to be unsustainable in the long term, on a point to point basis.
22. UTG said that European models provided evidence that joint ownership, investing in rail links and re-orienting competing bus services to complement rail networks can offer a better quality of service to passengers.

Competition

23. UTG said there was a lot of potential for destructive competition, whereby profitability of services was undermined, and the consumer gets a worse quality of service.
24. UTG said the Competition Commission's local bus market inquiry concluded that there was actually not much direct competition between bus services operated by different operators running services in overlapping geographical areas.
25. UTG provided the example of East Leeds corridor along which Arriva run services to Leeds city centre from the nearby local authority area of Wakefield. First Group run services in the urban area of East Leeds. Although services overlap along much of the main road running east from Leeds city centre, the evidence shows they were competing on a very small proportion of the point to point market, so competitive constraints are unlikely to play a role in their decision making.
26. UTG said that as a generalisation the ownership of rail franchises changes more frequently than bus which was more stable.
27. UTG said they were more sceptical than CMA and ORR that Grand Central and the Hull Trains represented sustainable competition. UTG said these examples were not run on a level playing field because of differentials in track charges and revenue sharing through the settlement plan.
28. UTG felt franchised operators did not like this arrangement because open access operators creamed off the profits.

29. UTG said some UTG members liked what open access operators had done, because they introduced new direct services that had previously not existed, which had obvious benefits for the new areas being connected. But UTG said that much of the benefit could be achieved better through a franchised arrangement.
30. UTG said much of the fare structure that the rail operators stick to was heavily constrained by the franchise contract, and a lot more so for Northern than for intercity operators.
31. UTG said fare increases were constrained on the rail side. Overall, rail fares regulation also constrained bus fares in some cases, which made more difficult for operators to take advantage of consumers in this market.
32. UTG felt Arriva ran few services where they could exploit profitable fare increases, in part because the operation was loss-making in overall terms and generated relatively low ticket revenue.
33. UTG said the franchise was heavily regulated. A lot of revenue was from multi-operator, area-wide tickets that the rail operator only had marginal power over.
34. Innovation was about improvement to the service or promotional offers where there was discretion over spare capacity. UTG said Arriva had an opportunity to improve the service, but were in a more constrained position when it came to increasing fares.
35. UTG said a concentrated market of potential bidders for bus or rail was not desirable, and that large owning groups were more likely to be making excessive profits on the bus side. Profit margins of Arriva-owned bus operating companies in the city regions were closer to the industry average. And UTG did not feel that Arriva's size in the rail market was big enough to cause concern at present.
36. UTG said that, on the positive side, closer collaboration between Arriva owned rail and bus businesses in the city regions could facilitate innovations in ticketing, products and service provision.
37. UTG considered negotiations within ticketing schemes and the relationship between transport authorities and operators were sometimes difficult.
38. Some bus operators have done positive things.
39. UTG said that UTG members, as part of their informal regulatory role, were well placed to monitor relationships between operators.

40. UTG said that the ticketing block exemption was very important to UTG members, and that the CMA's recent guidance was helpful.

Concluding remarks

41. UTG said it was important that the CMA understands the role of city region transport authorities in the market. UTG regularly looked at profit margins for franchised bus operations, the deregulated bus market and rail franchised operations.
42. UTG's findings suggested the deregulated bus market in metropolitan areas was the most problematic in terms of excess profits, although defining an appropriate measure of profitability was more complex in the franchised rail market.