

Review of FirstGroup bus undertakings in Bristol

Provisional decision

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The Competition and Markets Authority has excluded from this published version of the provisional decision report information which the CMA considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X].

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Summary

1. On 31 January 2017, the Competition and Markets Authority (CMA) announced its decision to conduct a review of the undertakings given in 1989 (and amended in 1996) by Badgerline Holdings Ltd (Badgerline) under the Fair Trading Act 1973 (FTA) in relation to its bus operations in the area substantially covered at the time by Avon County Council (the Undertakings).
2. The Undertakings were given following the Monopolies and Mergers Commission's (MMC) conclusion that the acquisition by Badgerline of Midland Red West Holdings Limited (Midland Red West), trading as City Line, created a merger situation which might be expected to operate against the public interest.¹ The Secretary of State agreed with the MMC's conclusions and accepted undertakings offered by Badgerline. As it is further explained below, Badgerline is now FirsGroup Holdings Limited (FirstGroup). The full text of the Undertakings (and the amendments) is published separately on the case page of the CMA's website.
3. The CMA has a statutory duty to keep under review undertakings given under the FTA and the Enterprise Act 2002 (the Act) in the context of a merger investigation.² In particular, the CMA must, from time to time, consider whether, by reason of any change of circumstances, undertakings are no longer appropriate and need to be varied, superseded or released.
4. In assessing whether a change of circumstance has occurred in this case, we applied a threefold approach.
5. First, we considered the prevailing circumstances at the time of the merger that led the MMC to conclude that the merger would weaken competitive tendering for Avon County Council bus contracts. In particular, the MMC concluded that:
 - (a) there would be an increase in the anti-competitive practice whereby Badgerline, having deregistered certain commercial services, had

¹ The FTA was based on a 'public interest' test, although the underlying consideration in the public interest test was a lessening of competition. This is based on the 'Tebbit Doctrine' set out in 1984 by the then Secretary for State for Trade and Industry, Norman Tebbit – 'references to the Monopolies & Mergers Commission would be made primarily, but not exclusively, on competition grounds, taking into account the international dimension of competition.' See Antony Seely (January 2016), [Takeovers: the public interest test](#), section 2. The CMA now takes its decisions using a 'substantial lessening of competition' (SLC) test under the merger provisions of the Enterprise Act 2002.

² Sections 88(4) and (5) of the FTA (as preserved in Schedule 24 to the Act) and Sections 92(1), (2) and (3) of the Act. References in the report to the Undertakings shall be construed as references to the undertakings as amended in 1996.

reregistered them partially or wholly after failing to win the tendered contracts for the subsidised services replacing them; and

- (b) the loss of City Line as an independent major competitor for Avon County Council's contract services would weaken competitive tendering and thus increase the cost to Avon County Council of supporting socially necessary bus services or, in certain circumstances, make it impossible for Avon County Council to support those services to the full extent that it would wish to support them.

6. Second, we considered how the Undertakings were intended to address the adverse effects on competition arising from the merger. In this regard, we note that the Undertakings specifically apply to contract bus services (now commonly known as tendered services) and not to commercial bus services. In particular, the Undertakings impose two main obligations on Badgerline:

- (a) in circumstances where Badgerline or City Line deregisters a bus service and, following tenders for a subsidised service to replace all or part of this service, Avon County Council awards the contract to an operator other than Badgerline or City Line, then not to register a bus service which substantially duplicates such subsidised service without first giving four months' notice to the Director General and Avon County Council obtaining the consent of the Director General; and
- (b) an obligation to submit tenders to Avon County Council for every service in Avon and all services starting or finishing in Bristol, subject to specific requirements, including: (i) a requirement that the price quoted is calculated as not to exceed 120% of expected direct cost and revenue; (ii) a requirement to refund 50% of the excess revenue if the actual revenue exceeds the estimated revenue in any year; and (iii) a requirement to provide any information required by an independent auditor.

7. Third, we considered whether there has been any change in circumstances since 1986 that makes the Undertakings no longer appropriate and supports the need to vary, supersede or release the Undertakings. In this context, we found the following changes since 1989:

- (a) A significant reduction in LTA budgets for tendered bus services and, consequently, the operation of many previously tendered services on a commercial basis.
- (b) Changes in the structure of tenders and the granting of additional powers to LTAs in relation to local bus services.

- (c) The abolition of Avon County Council in 1996 and replacement with four local transport authorities (LTAs) and, in addition, the recent creation of the West of England Combined Authority (WECA).
- (d) The entry of a number of competitors since 1989 and a significant reduction in FirstGroup's market share of tendered services in the specified area. In contrast to the position in 1989, in the most recent tender rounds, FirstGroup did not win any contracts awarded by three of the four LTAs, with at least four competitors successfully bidding against FirstGroup in each tender round. In the tenders run by the fourth LTA, FirstGroup's share of tendered services reduced significantly in the most recent tender round.
8. We noted that all four LTAs told us that they were not aware of the Undertakings prior to our review. Neither were FirstGroup or its competitors. No party that we spoke to argued that the Undertakings were having a beneficial effect and should be retained.
9. We also considered whether the Undertakings, if now enforced, would enhance competition in local bus services in the specified area. In relation to the first element of the Undertakings, LTAs told us that there were either no or limited examples of FirstGroup deregistering a bus service and, following tendering for a subsidised service, launching a commercial service which substantially duplicates the tendered service. Some competitors raised concerns in relation to this practice, but the examples were very limited. In relation to the second element of the Undertakings, LTAs told us that there were sufficient bidders for tendered contracts and that a price not exceeding 120% of expected direct cost and revenue as required by the Undertakings would be far in excess of the price that they would expect or be prepared to pay for a contract in the current financial environment.

Provisional decision

10. We have provisionally found that by reason of a change of circumstances the concerns articulated by the MMC in 1989 no longer apply. We provisionally conclude that the Undertakings are not having any practical effect on competition, and that there would be no benefit to competition in retaining the Undertakings in their current form.
11. We also considered whether the Undertakings should be varied or superseded. We found FirstGroup's share of tendered bus services in the specified area has reduced significantly since the time of the MMC report. In the most recent tender rounds, FirstGroup did not win any contracts at three of the four LTAs, with a number of competing operators successfully bidding

for contracts; and at the fourth LTA its share of tendered services was significantly reduced in the most recent tender round. We also noted that retaining unnecessary behavioural remedies in force risks distorting market outcomes.

12. We therefore provisionally conclude that the Undertakings should be released. In parallel to this provisional decision we have published a notice of intention to release the Undertakings.
13. We are now consulting on this provisional decision. The consultation closes on **Friday 30 June 2017**. Please submit responses to:

Phil James
Project Manager
Competition and Markets Authority
6th Floor East
Victoria House
37 Southampton Row
London WC1B 4AD

Email: remedies.reviews@cma.gsi.gov.uk

14. Following this consultation, the CMA will consider the responses received and the evidence and views presented. The CMA will assess the impact of these responses on its provisional decision before reaching a final decision. A final decision is expected to be published in Summer 2017.

Provisional decision

1. Introduction and background

- 1.1 On 17 October 1988, the Secretary of State made a reference under the Fair Trading Act 1973 (FTA) to the Monopolies and Mergers Commission (MMC) for an investigation into the acquisition by Badgerline Holdings Ltd (Badgerline) of Midland Red West Holdings Limited (Midland Red West), trading as City Line.
- 1.2 In January 1989, the MMC delivered a report concluding that the acquisition created a merger situation which might be expected to operate against the public interest. The report recommended that the Director General of Fair Trading seek undertakings from Badgerline. The Secretary of State agreed with the MMC's conclusions. To address the concerns identified by the MMC, Badgerline offered undertakings in relation to its bus operations in the area covered at the time by Avon County Council (the Undertakings). The Undertakings were accepted by the Secretary of State on 3 October 1989.
- 1.3 In 1995, Badgerline merged with the Grampian Regional Transport Group to form FirstBus Group Limited, which was later renamed FirstGroup Holdings Limited (FirstGroup). This report refers to the original entities (ie Badgerline and Midland Red West) and the current entity (ie FirstGroup) depending on the timing of the points addressed. In 1996, certain provisions of the Undertakings were amended.³ The Undertakings currently apply to FirstGroup.
- 1.4 On 31 January 2017, the Competition and Markets Authority (CMA) announced its decision to conduct a review of the Undertakings. The CMA has a statutory duty to keep under review undertakings accepted under the FTA.⁴ In particular, the CMA must, from time to time, consider whether, by reason of any change of circumstances the undertakings are no longer appropriate and either:
 - (a) the relevant parties can be released from the undertakings; or
 - (b) the undertakings need to be varied or to be superseded by a new undertaking.

³ References in the report to the Undertakings shall be construed as references to the Undertakings as amended in 1996.

⁴ Sections 88(4) and (5) of the FTA (as preserved in Schedule 24 to the Act).

- 1.5 The CMA's decision to conduct a review of the Undertakings was made pursuant to the guidance in CMA11.⁵ This follows the commitment made in its [2016/17 Annual Plan](#) to build on a programme of work⁶ systematically to review its existing merger and market remedies and to remove measures that are no longer appropriate.

Background to remedies and the MMC's competition concerns

The MMC inquiry and the Undertakings

- 1.6 The MMC concluded in 1989 that the merger, which took place in 1988, would reduce competition in relation to Avon County Council's contract (ie tendered) bus services with the loss of one of the two principal bidders for the contracts as an independent competitive force. It concluded therefore that the merger might be expected to operate against the public interest.
- 1.7 The MMC identified two competition concerns in relation to contract bus services:
- (a) that there would be an increase in the anti-competitive practice whereby Badgerline, having deregistered certain commercial services, had reregistered them partially or wholly after failing to win the tendered contracts for the subsidised services replacing them; and
 - (b) that the loss of City Line as an independent major competitor for Avon County Council's contract services would weaken competitive tendering and thus increase the cost to Avon County Council of supporting socially necessary bus services or, in certain circumstances, make it impossible for Avon County Council to support these services to the full extent that it would wish to support them.
- 1.8 In relation to commercial bus services, the MMC found that Badgerline and City Line had not competed with each other prior to the merger and had regarded their services as complementary.
- 1.9 The MMC concluded that behavioural undertakings were required to remedy the concerns it had identified in relation to the contract bus services. To address such concerns, Badgerline offered the Undertakings. The Undertakings impose the following requirements on FirstGroup:

⁵ CMA (January 2011, revised August 2015), [Remedies: Guidance on the CMA's approach to the variation and termination of merger, monopoly and market undertakings and orders \(CMA11\)](#).

⁶ The CMA has a statutory duty to keep under review undertakings made under the Fair Trading Act 1973 as well as those under the Enterprise Act 2002.

(a) In circumstances where Badgerline or City Line deregisters a bus service and, following tenders for a subsidised service to replace all or part of this service, Avon County Council awards the contract to an operator other than Badgerline or City Line, then not to register a bus service which substantially duplicates such subsidised service without first giving four months' notice to the Director General and Avon County Council obtaining the consent of the Director General.⁷

(b)

(i) When Avon County Council invites tenders to operate bus services on a subsidised basis, Badgerline will submit tenders for every service in Avon, and City Line will submit tenders for all services starting or finishing in Bristol.⁸

(ii) The price quoted by Badgerline and City Line in each such tender will not exceed 120% of expected direct cost and revenue.⁹

(iii) In respect of each such successful tender if actual revenue exceeds estimated revenue in any year, then 50% of the excess will be refunded to Avon County Council.¹⁰

(iv) If requested so by Avon County Council, to provide an independent auditor such information as he may require to enable him to certify that the revenue and cost estimates incorporated in the tender prices are reasonable, and that the prices tendered and the refunds made have been determined in accordance with the terms of this undertaking.¹¹

(v) Badgerline will pay to the Avon County Council such adjustment as the auditor may specify.¹²

(vi) Badgerline will pay the fees of such auditor as may be appointed.¹³

⁷ As amended in 1996.

⁸ Original 1989 Undertakings.

⁹ As amended in 1996.

¹⁰ As amended in 1996.

¹¹ As amended in 1996.

¹² Original 1989 Undertakings.

¹³ Original 1989 Undertakings.

- (c) Badgerline will provide promptly to the Director General of Fair Trading such information as he may require to ascertain whether these undertakings are being complied with.¹⁴

FirstGroup's 2016 request for a review of the Undertakings

- 1.10 On 22 April, the CMA published a consultation concerning 38 merger remedies that were over 10 years old and invited comments on which of the remedies should be prioritised for review.¹⁵ In response to this consultation, the CMA received a submission from FirstGroup which requested a review of the Undertakings.¹⁶
- 1.11 FirstGroup requested that the Undertakings be released as a result of a change of circumstances. In this regard, FirstGroup submitted that:
- (a) The entity which the Undertakings sought to protect, Avon County Council, was abolished in 1996.
 - (b) The four unitary authorities which replaced Avon County Council have considerable countervailing buyer power and, since 2004, have worked together under the auspices of the West of England Partnership for major transport projects, thereby increasing their buyer power.¹⁷
 - (c) Local authority powers have changed since 1989, with a significant increase in the oversight of bus services by local authorities. The proposed devolution of additional powers to cities across the UK will increase the constraints that local authorities can impose on bus operators.
 - (d) Neither City Line nor Badgerline, nor any of their subsidiaries, operates any contract or commercial bus services in the affected area.
 - (e) FirstGroup's bus operations in the area have reduced in scale and scope since 1989.
 - (f) FirstGroup now faces increased competition for tendered services in the areas covered by the Undertakings.

¹⁴ Original 1989 Undertakings.

¹⁵ [Review of merger undertakings given before 1 January 2006](#), CMA, 13 June 2016.

¹⁶ [FirstGroup submission](#), 9 December 2016.

¹⁷ The West of England Partnership for major transport projects was formed to sustain prosperity and enhance the confidence of public and private investors in infrastructure.

- 1.12 FirstGroup also submitted that it was not aware of the Undertakings ever having been enforced or referred to in its dealings with the relevant local authorities which succeeded Avon County Council in 1996.

2. Overview of the nature of competition in tendered bus services and regulation

- 2.1 This section provides a brief overview of how competition works in relation to tendered bus services in England and sets out the key elements of the regulatory regime governing local bus services.

Overview of local bus competition

- 2.2 The Transport Act 1985 deregulated the provision of local bus services. Road service licensing for local services outside London was abolished and local authority subsidies were restricted to unprofitable services required to meet social need, with subsidies only being awarded after tenders from different operators.¹⁸ Deregulation took place in three stages during 1986 and, at the time of the MMC report, the tendering of local bus service contracts was still in its early years.
- 2.3 Over thirty years have passed since deregulation and a number of large commercial operators have established themselves, together with numerous smaller operators. The five largest bus operators in England are Stagecoach (19%), Arriva (17%), FirstGroup (13%), Go-Ahead (13%) and National Express (5%). Other large operators of local bus services account for 22% of services in England, with smaller operators accounting for the remaining 12%.¹⁹
- 2.4 The CMA and its predecessors, the OFT and Competition Commission, have reviewed competition in the local bus market, including through their market review and merger control functions. In 2011, the CC published the findings of its Bus Market Investigation Report.²⁰ The report identified three categories of competition between bus operators:²¹

¹⁸ The main provisions of the Transport Act 1985 were: the abolition of road service licensing for local services outside London and the introduction of local service registration; the restriction of subsidy for local services to unprofitable services required to meet social need, such subsidy to be awarded only after inviting tenders from different operators; and the National Bus Company to be split up and privatised and local authority bus operations to be formed into separate passenger transport companies operating at arm's length from the local authorities. The Transport Act 1985 removed restrictions on the quantity of local bus services supplied and permitted taxis to operate as local bus services.

¹⁹ DfT (2014), [Annual bus statistics: England 2013/14](#).

²⁰ [Bus Market Investigation Report](#).

²¹ Bus Market Investigation Report, paragraphs 26–33 and chapters 6 and 8.

- (a) Head-to-head competition – the constraint on operators from passengers switching to rival operators for a particular journey. This arises where operators overlap in whole or in part on their routes and compete directly.
- (b) Potential competition – the constraint on incumbent operators from the threat that nearby rivals might redeploy or expand their existing services and start competing head-to-head. Potential competitors are operators with existing services and facilities in or near the incumbent's area of operation.
- (c) New entry – the constraint on incumbent operators' current behaviour from the threat that new entrants might start competing head-to-head. New entrants are operators without existing services and facilities nearby.

2.5 We use this framework in Chapter 5 as part of our assessment of whether there has been a change of circumstances since 1989.

The role of local authorities

- 2.6 The majority of bus services outside London have been provided commercially by bus operators since the industry was deregulated. However, LTAs have a duty²² to secure the provision of public transport services where they consider it appropriate and the services would not otherwise be provided.²³ A need to secure such services may be identified, for example, if existing commercial services are considered not to meet social needs or provide adequate services to rural areas.²⁴
- 2.7 Services can be procured for a whole route or for part of a route, and similarly for the whole of the timetable or just certain days or times of day (for example, Sundays or late evenings).

²² Under the Transport Act 1985 (sections 57 and 63), LTAs have a duty, and non-metropolitan district councils have power, to secure the provision of public transport services that they consider appropriate to meet social needs and that would not otherwise be available. The Transport Act 2008 widened the criteria to include the ability to support services which would otherwise not be provided to a particular standard which includes frequency or timing of service, days or time of day operating or the vehicles used.

²³ Procured services may be referred to as tendered services or supported services. The service is supported in the sense that it would not otherwise be provided commercially, but these contracts are not intended to provide any financial support to bus operators other than payment for the provision of the service.

²⁴ Different types of services may be procured: scheduled services; services to transport schoolchildren and students; and demand-responsive services. Contracts relating to park-and-ride services are more likely to be motivated by a desire to reduce congestion and for environmental benefits, or to stimulate economic activity in town centres.

The tendering of contracts

- 2.8 Where LTAs are procuring such services, they are generally required to invite competitive tenders from operators.²⁵ This is to enable authorities to award the contract to the most economically advantageous tender and to achieve best value.²⁶ Any bus operator can be eligible to bid for a contract provided it has the appropriate licence and resources to operate the service.
- 2.9 A contract for a tendered service usually specifies the detail of the service including the route and timetable, and may specify fares to be charged. In addition, the type of vehicle to be used, its capacity, accessibility, engine rating etc are increasingly specified in the contract. Tenders may cover the operation of more than one service, and more than one contract may be tendered at one time allowing operators to bid for 'bundled contracts'. This may allow an operator to develop a significant scale of supported operations and to make more effective use of vehicles and drivers. Most contracts contain clauses that allow them to be suspended if another operator decides to register the same service and to run it commercially.
- 2.10 An important provision in the contract is which party receives the revenue from operating the service and so takes the revenue risk in the contract. There are two main approaches:
- (a) cost-based (often known as gross or minimum cost): the LTA pays the operator to provide services and retains the revenue from passengers, with the operator tendering for the whole cost of running the service (ie the revenue risk is taken by the LTA); and
 - (b) subsidy-based (often known as net cost or minimum subsidy): the operator retains the revenue from passengers and tenders for the cost of operating the service less the estimated revenue (ie the revenue risk is taken by the operator). In producing a bid, the operator will have estimated the likely amount of revenue.

²⁵ LTAs must generally invite competitive tenders for any contract (Transport Act 1985, section 89).

²⁶ In deciding which tender to accept, LTAs must have regard to a combination of economy, efficiency and effectiveness; the implementation of the policies set out in the bus strategy; and the reduction or limitation of traffic congestion, noise or air pollution (Transport Act 1985, section 89).

De minimis payments

- 2.11 In some cases, LTAs are exempted from the requirement to undertake a competitive tender process for the award of contracts for supported services. An exemption will be applied where a contract is below the *de minimis* limits.²⁷

Partnerships between LTAs and commercial bus operators

- 2.12 LTAs may partner with commercial bus operators by way of:

- (a) Voluntary partnership agreements (VPAs) – a voluntary agreement between an operator and at least one LTA covering a range of issues, but usually specifying an expected level of service to be delivered by each party.
- (b) Quality partnership schemes (QPSs) – the LTA agrees to provide particular facilities in their area, such as improved bus stops or new bus lanes, and operators wishing to use those facilities undertake to provide services of a particular standard (eg using new buses).²⁸
- (c) Quality contract schemes (QCSs) – the LTA controls the provision of bus services through a tendering process. The QCS shares similarities with the franchising approach in London, although there are currently none in operation.

- 2.13 The Bus Services Act 2017 (the Bus Services Act), which aims to ‘drive up bus use, help cut congestion and deliver economic growth’ received Royal Assent on 27 April 2017. The Bus Services Act introduces a number of changes to the current mechanisms and powers of LTAs:

- (a) QPSs are extended to ‘advanced quality partnerships’ which will allow for the LTA to introduce measures (eg traffic policies) as well as, or instead of, facilities. It will also broaden the requirements that can be placed on operators to include their marketing approaches.
- (b) LTAs are granted the power to propose ‘enhanced partnerships’ in geographic areas. These proposals require the support of a majority of

²⁷ The *de minimis* limits are set out in the Service Subsidy Agreements (Tendering) (England) (Amendment) Regulations 2004. LTAs with forecast expenditure of £600,000 or more in any one year will be able to spend up to 25% of this on *de minimis* contracts. For LTAs with forecast expenditure below this level, expenditure per contract in any one year has a limit of £30,000. The maximum length of any *de minimis contract* is five years. Separately, there are exceptions for up to three months where action is urgently required for the purpose of: maintaining an existing service; securing a service which has ceased to exist; or securing a service to meet a public transport requirement which has arisen unexpectedly and ought to be met without delay.

²⁸ The Local Transport Act 2008 expanded the terms of the QPS model to allow a local authority to specify requirements regarding frequencies, timings or maximum fares as part of the standard of service to be provided, in addition to quality standards.

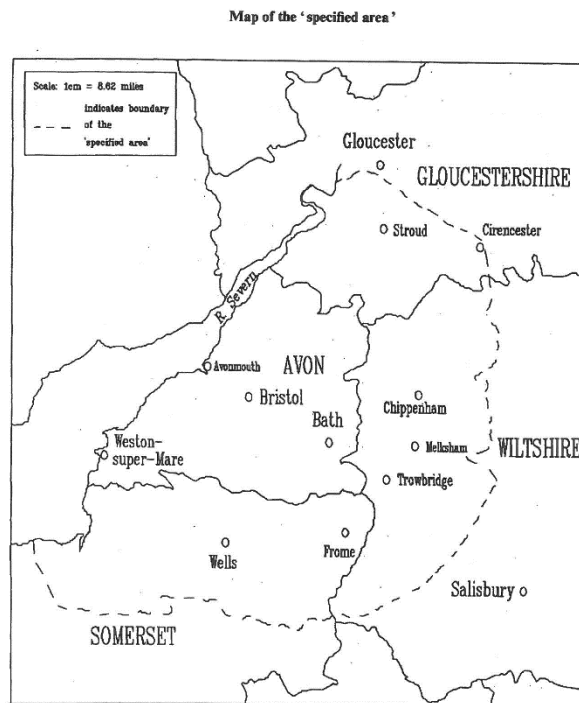
operators in the area in order to be implemented. The partnership will then work to set standards and timetables/frequencies within the area, although it cannot determine fares, or compel operators to run services that they do not wish to run.

- (c) New franchising powers are provided to certain local authorities to introduce franchising to their local areas (similar to those in London). The decision needs to be assessed by the local mayor (or equivalent), and other key elements of the cost-benefit analysis will need to be assured by an independent auditor. The first West of England mayor (sometimes described as a 'metro mayor') was elected on 4 May 2017 and has the power to franchise local bus services.
- (d) LTAs are provided with additional data gathering powers, particularly when a commercial route is being cancelled.

3. Geographical context

- 3.1 The MMC described the specified area for the supply of bus services as the County of Avon together with all parts of the Counties of Somerset and Wiltshire and of the County of Gloucester east of the River Sever which lie within 15 miles of the County of Avon.

Figure 1: Map of the 'specified area' defined by the MMC



4. Our approach

Our legal duties

- 4.1 The CMA has a statutory duty to keep under review undertakings given under the FTA and the Act in the context of a merger investigation.²⁹ In particular, the CMA must, from time to time, consider whether, by reason of any change of circumstances, undertakings are no longer appropriate and need to be varied, superseded or released.
- 4.2 Our guidance notes that the precise nature of the CMA's consideration of any change of circumstances will depend entirely on the individual circumstances affecting a particular undertaking. However, the change of circumstances must be such that the undertaking is no longer appropriate in dealing with the competition problem and/or adverse effects which it was designed to remedy, if it is to lead to either the variation or termination.³⁰ This is a matter of judgement for the members of the CMA who are conducting this inquiry.
- 4.3 Our guidance also identifies the following three types of circumstances that have led to the variation or termination of undertakings in the past:
- (a) undertakings that have time-expired or clearly become obsolete;
 - (b) undertakings that are affected by new legislation; and
 - (c) undertakings that are affected by changes in market conditions.³¹
- 4.4 The Undertakings were given under section 88 of the FTA. Paragraph 16(2) of Schedule 24 to the Act gives the CMA itself the power to vary, remove or supersede undertakings given under the FTA that have been specified in an Order made by the Secretary of State. The Undertakings fall within the category of undertakings that have been specified in an Order made by the Secretary of State.³² Therefore, the final decision to vary, remove or supersede the Undertakings remains with the CMA.
- 4.5 As indicated above, when assessing whether there has been any change of circumstances in this case, we have followed a threefold approach:

²⁹ Sections 88(4) and (5) of the FTA (as preserved in Schedule 24 to the Act) and sections 92(1), (2) and (3) of the Act.

³⁰ CMA (January 2011, revised August 2015), *Remedies: Guidance on the CMA's approach to the variation and termination of merger, monopoly and market undertakings and orders (CMA11)*, paragraph 2.5.

³¹ Ibid, paragraph 2.6.

³² The Undertakings are specified in the Enterprise Act 2002 (Enforcement Undertakings and Orders) Order 2004 (Statutory Instrument 2004 No.2181).

- (a) first, we have considered the prevailing circumstances that led the MMC to conclude that the Badgerline/Midland Red West merger ‘operated against the public interest’ with identified adverse effects;
- (b) second, we have considered how the undertakings were intended to address the adverse effects arising from the merger; and
- (c) third, we have considered whether there has been any change in circumstances since 1989 that makes the Undertakings no longer appropriate.

4.6 The Undertakings were given nearly 30 years ago and market information from the time is limited. To the extent possible we have therefore sought to focus on any relevant changes since 1989 and their effect on the concerns raised in the MMC Report.

Evidence gathering

- 4.7 In deciding to review the Undertakings, the CMA obtained evidence through its own research and information provided by FirstGroup to establish a realistic prospect of finding a change of circumstances.³³
- 4.8 During the review process we received questionnaire responses and/or submissions from six competitors to FirstGroup and the four LTAs which replaced Avon County Council, namely Bath & North East Somerset Council (BANES), Bristol City Council (BCC), North Somerset Council (North Somerset) and South Gloucestershire Council (South Gloucestershire). We also held hearings in Bristol with the four LTAs.

5. Assessment of change of circumstances

- 5.1 In this section we discuss the concerns identified by the MMC in 1989 and assess whether there has been any change of circumstances such that the concerns no longer apply or the Undertakings are no longer appropriate in dealing with the problems identified by the MMC.
- 5.2 We set out:
 - (a) The nature of the MMC’s concerns in 1989.

³³ CMA (January 2011, revised August 2015), [Remedies: Guidance on the CMA’s approach to the variation and termination of merger, monopoly and market undertakings and orders \(CMA11\)](#), paragraph 3.10.

- (b) The views of FirstGroup and third parties on whether circumstances have changed.
- (c) CMA assessment of whether circumstances have changed.
- (d) The implications of a change of circumstances for the Undertakings.
- (e) The impact of removing the Undertakings.

The nature of the MMC's concerns in 1989

- 5.3 In relation to commercial services, the MMC found that Badgerline and City Line did not compete directly pre-merger and further concluded that there would be no material loss of potential competition in commercial services as a result of the merger.
- 5.4 In relation to tendered services, the MMC found that Avon County Council tendered 80 per cent of services by value. Avon County Council was concerned that, if Badgerline and City Line would no longer compete for these tenders post-merger, tender prices would increase leading to some curtailment of tendered services.
- 5.5 The MMC expected that the two operators would co-ordinate their bidding for Avon County Council's contracts post-merger and concluded that effective competition between Badgerline and City Line would disappear as a result of the merger, with the loss of one of the two principal bidders for the contracts as an independent competitive force. The MMC found that there was no prospective competitor of equal weight to City Line in the specified area to act as an independent competitive force.
- 5.6 The MMC identified two serious detriments to competition for Avon County Council's contracts as a result of the merger:
 - (a) an increase in the anti-competitive practice whereby Badgerline, having deregistered certain commercial services, had reregistered them partially or wholly after failing to win the tenders for the subsidised services replacing them; and
 - (b) the loss of City Line as an independent major competitor for Avon County Council's tendered services.
- 5.7 The MMC noted that substantial benefits arose from the merger but that these did not, in its view, outweigh the detriments identified.
- 5.8 The MMC concluded that the merger may be expected to act against the public interest as it would weaken competitive tendering and thus increase the

cost to Avon County Council of supporting socially necessary bus services or, in certain circumstances, make it impossible for Avon County Council to support these services to the full extent that it would wish to support them.

- 5.9 The MMC considered that divestment would be an unnecessarily drastic remedy and recommended that the Director General of Fair Trading seek behavioural undertakings.
- 5.10 Two members of the MMC group dissented from the above conclusions in relation to tendered services. They considered that the loss of a major competitor for Avon County Council's tendered services would be offset by increased competition from other bus companies. As a result, there was no reasonable expectation that the merger would lead to an increase in tender prices or reduction in socially desired services. They did not find that Badgerline's reinstatement of commercial services was anti-competitive and considered there to be no evidence that the practice had deterred competitors. Furthermore, they thought it reasonable to give more weight to the actual and potential benefits of the merger than to the possibility of increases in tender prices in a small and decreasing number of cases at a time when competition from other firms seemed to be strengthening.
- 5.11 The dissenting members concluded that neither of the two undertakings was necessary and that both had serious disadvantages. Their conclusion was that the merger may be expected not to operate against the public interest.
- 5.12 The rest of this report focuses on whether circumstances have changed such that the MMC's concerns no longer persist and, consequently, that the remedies are no longer necessary.

The views of FirstGroup and third parties on whether circumstances have changed

- 5.13 Below we summarise FirstGroup's and third party views on whether circumstances have changed since the MMC's report in 1989.

The views of FirstGroup

- 5.14 FirstGroup requested that the Undertakings be released as a result of a change of circumstances for the reasons set out below.

Avon County Council has ceased to exist

- 5.15 FirstGroup submitted that the entity which the Undertakings sought to protect, Avon County Council, was abolished in 1996, together with the county of Avon.
- 5.16 FirstGroup told us that the four unitary authorities which replaced Avon County Council have considerable countervailing buyer power and, since 2004, have worked together under the auspices of the West of England Partnership for major transport projects, thereby increasing their buyer power.

Changes to local authority powers since 1989

- 5.17 FirstGroup submitted that local authority powers have changed since 1989, with a significant increase in the oversight of bus services by local authorities. In particular, FirstGroup highlighted that the Transport Act 2000 provides a framework for LTAs to enhance the provision of local bus services and that the devolution of additional powers to cities across the UK will increase the constraints that local authorities can impose on bus operators. FirstGroup told us that three of the four authorities which replaced Avon County Council are proposing to move ahead with a devolution deal which will explicitly include public transport in its remit. FirstGroup also highlighted the additional powers granted to LTAs under the Bus Services Bill (discussed in paragraph 2.13).³⁴

Neither City Line nor Badgerline, nor any of their subsidiaries, operates any bus services

- 5.18 FirstGroup told us that Badgerline Holdings Limited changed its name to Badgerline Group plc in 1993 and then to FirstGroup Holdings Limited in 1997, with the latter being a non-operational holding company. FirstGroup also told us that Midland Red West Holdings Limited changed its name to FirstBus Group Limited in 1997 and is a subsidiary of FirstGroup Holdings Limited. FirstGroup submitted that neither entity holds an operating licence or operates any bus services and that the only FirstGroup operating companies providing bus services in the area covered by the Undertakings are First Bristol Limited and First Somerset & Avon Limited.
- 5.19 We note, however, that although there have been changes to the name of Badgerline Holdings Limited, the legal entity to which the Undertakings apply remains the same and any rights or obligations of the company continue to apply. We therefore do not consider this point further.

³⁴ The Bus Services Act 2017 had not received Royal Assent at the time of FirstGroup's submission.

Increased competition

- 5.20 FirstGroup submitted that its bus operations have reduced in scale and scope since 1989.³⁵ FirstGroup told us that it faced increasing competition in the areas affected by the Undertakings from a number of operators, including national operators such as Rotala Buses Limited³⁶ and Bath Bus Company³⁷, as well as sizeable local operators, including Faresaver Buses of Chippenham, Crosville Motor Services (based in Weston-Super-Mare) and Abus as well as a number of smaller operators.
- 5.21 FirstGroup also told us that the competitive constraint exerted by the private car has increased significantly since 1989 across the area covered by the undertakings and noted that Bristol has also seen the introduction of car sharing services and innovative services such as Uber and SlideBristol. FirstGroup submitted that these new options for passengers to travel by public and private transport have, or are highly likely to have, a significant impact on the level of competition it faces.

The change in circumstances make it appropriate to release the undertakings

- 5.22 FirstGroup submitted that the undertakings have become unnecessary as the concern they were originally designed to address can no longer be considered material or relevant.

The views of third parties

Local Authorities

- **BANES**

- 5.23 BANES oversees bus services in Bath, Keynsham and rural areas. BANES told us that it faces financial constraints and that the net spend on bus revenue support from our budget has reduced by £400,000 between 2015/6 and 2017/8 (i.e. two years) to £537k. In addition, BANES has made use of £360,000 of third-party funding (such as developer contributions) to support bus services in 2016/7. Falling tender prices and FirstGroup's ability to take on certain former tendered services commercially has limited the extent to

³⁵ As an example, FirstGroup told us that the combined fleet of First Bristol Limited and First Somerset & Avon Limited (excluding Somerset operations) was [REDACTED] in October 2005, whereas the equivalent fleet size was [REDACTED] in November 2016.

³⁶ Rotala first entered the area in April 2007, operating in Bristol under the trading name of Wessex Connect. Later the same year, the bus business of South Gloucestershire Bus and Coach Company was acquired and rapid growth has followed.

³⁷ Bath Bus Company is a part of the RATP group, a French state-funded public transport operator.

which BANES has had to reduce tendered services, although the frequency of some tendered services has been reduced.

- 5.24 BANES told us that 90% of the bus services in its urban areas are commercial. By contrast, in rural areas, BANES said that there are only a handful of commercial services. BANES has 25 tendered contracts in place at the moment (mainly for shopper trips and orbital routes).
- 5.25 BANES said that it has a rolling tender programme and invites bids on both a gross and net cost basis. BANES typically uses six or seven contractors and had eight at the time of its submission to us. BANES told us that FirstGroup bids for large contracts and for add-ons to commercial services but does not bid for rural services or small contracts. BANES said that this enables smaller operators to enter the tendered market.
- 5.26 BANES told us that 19 contracts were offered to the market in five batches over the past 3 years, with four or five bidders for each, and 14 of those were awarded. However, for weekly rural services and late evening add-ons to commercial services, there are fewer bidders.
- 5.27 Although BANES is not able to estimate individual tender margins, it considers that it is achieving value for money in tendered bus services. The West of England Combined Authority (see paragraphs 5.58 and 5.59) may have greater buyer power than individual LTAs.
- 5.28 BANES said that it is not aware of many examples of re-registering commercial services following tenders and that such behaviour is less likely to arise as operators know that LTAs are unlikely to fund services that were operated commercially.

- *BCC*

- 5.29 BCC told us that its contracts for tendered bus services are five years in length, although they can be extended by a short period. BCC said that it tenders bus services in packages in order to incentivise new entry by operators.
- 5.30 BCC said that its budget for tendered services was £4 million in 2010 and had now reduced to £2 million, with a further 50% reduction planned over the next two years. BCC told us that it had retained key bus routes by commercialising bus services and focusing tendering on the most essential services. FirstGroup has retained most of the services previously supported by BCC as, in the view of BCC, it saw the benefits of operating the services. BCC also

said that the general growth in the bus market in Bristol is supporting the commercialisation of services.

5.31 BCC told us that its strategic role is changing with the creation of WECA, with which it will jointly exercise transport powers. WECA will hold the budget for tendered services and its powers are expected to grow with the election of a metro mayor. BCC also said that franchising could also change the dynamics of the market in future years.

5.32 In relation to its most recent tender process, BCC said that four companies tendered for the standalone routes (mainly orbital routes and shopper routes), namely Abus, CT Plus, Rotala and Stagecoach. There were two or three bidders for each route. BCC told us that [REDACTED].

5.33 BCC told us that Stagecoach was a new entrant to the Bristol area, currently expanding in South Gloucestershire and seeking a depot to serve North Bristol. In BCC's view, Stagecoach was likely to be the main challenger to FirstGroup. BCC said that park-and-ride contracts were one entry route for operators and that both Rotala and CT Plus entered the Bristol area through such contracts. BCC noted that access to depots can disincentivise new entrants, although Rotala was able to rent depot space.

- *North Somerset*

5.34 North Somerset told us that its bus services cover areas including Weston-super-Mare, Cleveland and Portishead. North Somerset said that the core commercial inter-urban bus network is operated commercially by FirstGroup and that there is competition in urban areas.

5.35 In relation to tendered services, North Somerset told us that it has between 15 and 20 tendered contracts, including add-ons to commercial services, with standard contracts lasting for three years.

5.36 North Somerset told us that FirstGroup tenders for inter-urban and Weston-super-Mare contracts [REDACTED]. Smaller operators tender for contracts, with four of five generally interested, including Abus, Bakers Dolphin, Blue, Carmel Coaches, Coombs and Eurotaxi.

5.37 North Somerset said that its budget for tendered services reduced from £900,000 in 2010 to £300,000 in 2017. In order to address this, North Somerset has focused on redesigning services and some bus operators have commercialised routes.

- *South Gloucestershire*

- 5.38 South Gloucestershire told us that it currently has 34 supported routes, of which most are rural. FirstGroup focuses on operating services on radials to Bristol from towns such as Thornbury, Yate and Chipping Sodbury.
- 5.39 In relation to tenders, South Gloucestershire told us that its contracts are generally for three years with a possibility of a one year extension, with ten contracts being tendered per year under a rolling programme.
- 5.40 South Gloucestershire said that bus operators present in the area include SGB&C, Eurotaxi, FirstGroup, Severnside and Wessex. It said that new building developments are attracting bus operators to the area, partly as a result of section 106 income.³⁸ In particular, South Gloucestershire identified [X] as being interested in operating services between [X] and [X], although it would require a depot in order to do so.
- 5.41 South Gloucestershire's budget for tendered services has fallen from £2 million four years ago to £1 million today, with a further saving of £250,000 sought by 2018/19.

Competitors

- 5.42 Abus submitted that:
- (a) More bus companies now operate in Bristol than at the time of deregulation in 1986, including Stagecoach, Rotala, CT Plus and RATP. Go-Ahead also operates in the BANES area.
 - (b) Over the period since the Undertakings were given, the number of operators available or interested in bidding for tenders has remained the same but those operators have become bigger with four of the main groups submitting bids and at least two other large groups bidding for major contracts.
 - (c) The amount of funding for supported services has dropped dramatically since 1986. Current funding from the four unitary authorities is less than the £5 million provided by Avon County Council in 1986.³⁹

³⁸ Planning obligations, also known as section 106 agreements (based on that section of the Town & Country Planning Act 1990) are private agreements made between local authorities and developers and can be attached to a planning permission to make acceptable development which would otherwise be unacceptable in planning terms.

³⁹ Abus considered that if inflation adjusted, this £5 million would equate to around £30 million today.

- (d) The Buses Bill and the metro mayoral election will change the methods of provision of bus services in the area completely. The Undertakings could affect the bidding for any future franchised bus operations.

5.43 Rotala submitted that:

- (a) It is not aware of the Undertakings but, having now considered their provisions, it considered that FirstGroup had breached the Undertakings.
- (b) FirstGroup had opened up commercial routes to compete with contract routes awarded to other operators. For example, in South Gloucestershire, FirstGroup registered commercial services on 80% of Rotala's tendered routes. This resulted in tenders being withdrawn and Rotala exiting from the routes. Rotala stated that FirstGroup then requested *de minimis* payments from BCC and South Gloucestershire.
- (c) Competition grew in the Bristol area since Rotala's entry in 2007, with FirstGroup beginning an aggressive response in 2013 which led to reduced competition.
- (d) Council tendering practices had not changed since 2007.
- (e) Rotala bids for council and other contracts, although it now operates at a loss with a fleet reduced from 100 to 45 vehicles. The surplus buses have been re-deployed elsewhere in the country.
- (f) A number of operators no longer compete for contracts, including Buglers, South Gloucestershire Bus and Coach, Eurotaxi and Severnside. Abus remains active.

5.44 Somerbus submitted that the Undertakings were now not relevant. It stated that in 1989 there were no operators other than Badgerline and City Line bidding for the larger tendered contracts but that today Rotala, RATP, Hackney Community Transport (CT Plus) and Stagecoach are all taking an interest in bus service contracts in the Bristol area. As such, Somerbus said that there is little chance that the authorities will not see very competitive pricing. Somerbus also said that the number of contracts available and the amount of subsidy available has fallen considerably.

5.45 [X] submitted that it was difficult to compete in the market given the presence of FirstGroup.

5.46 [X] submitted that:

- (a) Competing operators have not grown. Rotala entered the market but its position has not considerably increased, indicating how difficult it is to enter the market.
- (b) The four local authorities do not have increased buyer power and there is a lack of an effective competitive market. FirstGroup is far bigger than all competitors and is well coordinated across the West of England, whereas there is no clear political mandate for the local authorities to impose transport policy objectives in the same area. This makes any combined decision process challenging and will not automatically be resolved with the combined authority.
- (c) The local authorities were weaker than they were and there has not been real challenge to the dominant operators, which was illustrated by [✂].

The CMA's assessment of whether circumstances have changed

5.47 In this section, we examine whether by reason of any change of circumstances, the Undertakings are no longer appropriate and need to be varied, superseded or released.

5.48 Specifically, we examine:

- (a) Demand-side considerations.
- (b) Supply-side considerations.

5.49 In our assessment, we take account of the views of FirstGroup, LTAs and competitors.

Demand-side considerations

- *Shrinking budgets for tendered bus services*

5.50 FirstGroup told us that LTA budgets have reduced significantly in recent years, declining faster since 2012. As a result, the number of tendered services has been reduced significantly.

5.51 All four LTAs told us that their budgets for tendered bus services have reduced significantly since 2010 as overall local authority budgets fell following the 2010 comprehensive spending review. As a result, LTAs said that they now tender fewer bus services, with services which were formerly tendered either being commercialised by bus operators or withdrawn.

- 5.52 This trend is consistent with data from the Department for Transport. In England (outside London) over the ten years to 2014-15, local authority supported mileage has decreased by 55 million miles and commercial mileage has increased by 13 million miles. The percentage of bus mileage on supported services has decreased from 22% in 2004-05 to 17% in 2014-15.⁴⁰
- 5.53 In 1987-88, Avon County Council spent £3.7 million on subsidising local bus services. By 2018, the total budget for tendered bus services across the four LTAs is approximately £2.6 million. Taking account of inflation, it is clear that spending by the LTAs on tendered bus services is now significantly less than half of that in 1989.
- 5.54 In relation to the MMC's first concern regarding an increase in anti-competitive practice (see paragraph 5.6), LTAs also said that the reduction in funding for tendered bus services made it less likely that deregistered commercial services would be put out to tender, reducing the scope for FirstGroup to reregister the services commercially if it bid unsuccessfully in the tender. Moreover, there were very few examples from LTAs and competitors of this practice taking place in recent years (a number of the examples involved FirstGroup registering commercial services which compete with tendered services, but did not follow tenders in which FirstGroup had participated). In addition to the impact of reduced funding, LTAs also suggested that the decline of this practice was a result of the market for local bus services being more mature than it was at the time of the MMC report. This point was illustrated by BANES, which noted that Avon County Council's policy in 1989 was to maintain the prevailing bus route network. To this end, Avon replaced any withdrawn commercial service on a short-term basis pending review and that policy was exploited by bus operators. BANES does not have that policy and considers each case as it occurs.
- 5.55 LTAs told us that section 106 payments by developers (see paragraph 5.40), which were not available in 1989, are now an important source of funding for specific bus services serving certain building developments. Although section 106 income is not part of the budget of LTA's for tendered bus services, the introduction of section 106 payments is a change to the dynamics of the local bus market since 1989.

⁴⁰ Department for Transport, [Annual bus statistics England 2014/15](#).

- *The structure of tenders*

5.56 There have been a number of changes to the tendering processes adopted by LTAs since 1989. In particular:

- (a) It is now common to tender for add-ons to commercial services (e.g. evenings and Sundays).
- (b) BCC now tenders bus services in packages rather than under a rolling programme.
- (c) Park-and-ride tenders have become an important route for a bus operator to enter a local area.
- (d) Tendering processes have adapted to reflect new legislation, such as the Procurement Contracts Regulations (2006) and, in relation to the level of *de minimis* payments, the Service Subsidy Agreements (Tendering) (England) (Amendment) Regulations 2004.

- *Changes to local authorities*

5.57 FirstGroup, LTAs and competitors highlighted the change in local authorities in the specified area since 1989. Avon County Council was the county council of the non-metropolitan county of Avon at the time of the MMC report.⁴¹ It was created on 1 April 1974⁴² and was abolished on 31 March 1996 (at the same time as the County of Avon was abolished), being replaced by BCC, South Gloucestershire, North Somerset and BANES. The four LTAs have worked together under the West of England Partnership for major transport projects since 2004.

5.58 Further change is taking place with the introduction of WECA, which was originally proposed by the government in 2016 with the aim of delivering growth in the region. The first West of England mayor was elected on 4 May 2017. WECA has four members, namely the Mayor of Bristol, the leaders of BANES and South Gloucestershire and the Mayor of the West of England. WECA will work in partnership with North Somerset, which is not part of WECA.

5.59 WECA is gaining funding and powers over local transport, including responsibility for a key route network of selected local roads. In relation to

⁴¹ It comprised the county boroughs of Bristol and Bath and parts of the Administrative Counties of Gloucestershire and Somerset.

⁴² Avon County Council was created under the Local government Act 1972.

buses, the West of England mayor will have the ability to franchise bus services, subject to local consultation.⁴³

- *Changes to the regulatory framework*

- 5.60 As set out in Chapter 2, there have been a number of changes to the regulatory framework for local buses since 1989 which grant LTAs additional powers in relation to bus operators. These include the Transport Act 2000 and the Local Transport Act 2008.
- 5.61 In particular, the Local Transport Act 2008 includes various provisions designed to enable more effective partnership working between LTAs and bus operators such as VPAs, QPSs and QCSs.
- 5.62 Where VPAs, QPSs or QCSs are in operation, they may have implications for the incentives of commercial bus operators. The impact of partnership agreements will vary from a relatively strong regulatory constraint on bus operators (for QCSs) to weaker constraints based on risks to operator relationships with LTAs (for VPAs).
- 5.63 The Bus Services Act grants further powers to LTAs to propose enhanced partnerships and to franchise local bus services.

- *Conclusion on the demand-side*

- 5.64 In relation to demand-side considerations, we note that the significant reduction in LTA budgets has reduced the scale of competition concerns since the time of the MMC's report. We provisionally conclude that this is a relevant change of circumstance.
- 5.65 We also note that some of the changes to the structure of tenders and, in particular, batch tendering and the opportunity to bid for park-and-ride contracts, appear to have increased the opportunities for new operators to bid for contracts. Changes to the regulatory framework have increased the scope for LTAs to exercise power over bus operators, although the impact of the Bus Services Act in the specified area is not yet clear.

⁴³ We note the observation made by Cllr Anthony Clarke, Cabinet Member for Transport for BANES, that WECA is now the local transport authority for the BANES area and is jointly responsible with BANES for supported bus services. Cllr Clarke told us that it would be more appropriate to review the Undertakings when WECA has become fully operational. However, our review is focused on assessing whether a change of circumstances has occurred since the MMC's report and, to this end, we have had regard to the recent creation of WECA.

Supply-side

- *Competitors*

- *Companies in the specified area at the time of the 1989 MMC Report*

5.66 The MMC found Badgerline supplied 40% of bus miles in the specified area in 1988 and that City Line supplied 42% and that the operators received a similar proportion of the subsidy provided by Avon County Council for local bus services.⁴⁴ In the County of Avon, Badgerline and City Line accounted for 90% of bus miles.

5.67 In relation to tendered services, the MMC analysed tenders between 1986 and 1988 and found that 34% of contracts by value (22% by volume) were bid for by Badgerline and City Line alone, with a further 8% by value (12% by volume) by the two companies and one other.⁴⁵ There were some differences in the geographic focus of Badgerline and City Line, with City Line being the leading operator in Bristol, Kingswood and Northavon and Badgerline predominant in the rest of the County of Avon. This was reflected in the MMC's analysis of tenders between 1986 and 1988.⁴⁶

5.68 The MMC listed various competitors to Badgerline and City Line, including Cheltenham & Gloucester Omnibus, Southern National, Wilts & Dorset, National Welsh and National Express.⁴⁷ The MMC also noted the presence of smaller competitors. However, the MMC did not specify which of these operators competed for tendered services.

- *Companies in the specified area today*

5.69 FirstGroup and LTAs identified a number of bus operators who are actual or potential competitors for tendered contracts in the geographic area to which the Undertakings relate:

(a) Abus – an independent bus company providing local bus services around Bristol, Bath and the West Country.

⁴⁴ MMC report, paragraphs 3.11, 6.9 and 7.17.

⁴⁵ MMC report, paragraph 3.34.

⁴⁶ MMC report, paragraphs 3.11 and 3.36.

⁴⁷ Southern National is now owned by FirstGroup, Wilts & Dorset is now owned by Go-Ahead Group and the Cheltenham & Gloucester Omnibus and National Welsh are now owned by Stagecoach.

- (b) Bath Bus Company (part of RATP Dev) – an operator of open bus tours in various English cities which also runs Air Decker services between Bath and Bristol airport.
- (c) Crosville Motor Services – a bus and coach operator based in Weston-super-Mare.
- (d) CT Plus (part of HCT Group) – a bus operator providing contract bus services in Bristol with operations in other parts of England, including London, Hull and Yorkshire. CT Plus opened a new depot in Bristol as part of its expansion.
- (e) The Kings Ferry (part of National Express) – a coach operator which previously provided services in Bristol and South Gloucestershire under contract to North Somerset.
- (f) Somerbus – an established small family owned operator of bus services in the Bristol and Bath areas.
- (g) Stagecoach West (part of Stagecoach UK Bus) – a bus operator providing services in Gloucestershire, Wiltshire and Herefordshire. The company is expanding in South Gloucestershire and is identified by BCC as a potential entrant to the Bristol area.
- (h) Wessex Bus (part of Rotala) – a bus operator which has provided bus services in the Bristol and Bath areas since 2007, with depots at Avonmouth and Keynsham.
- (i) A number of other operators including A&C, Bakers Dolphin, Blue, Carmel Coaches, Coombs, Citistar, Eurotaxi, Severnside and Thamesdown buses (part of the Go-Ahead Group).

5.70 Each LTA told us that they consider there to be sufficient competition for tenders, although we note that there was some variation in the number and identity of the operators considered to be competitors for tendered bus services by FirstGroup and individual LTAs.⁴⁸

5.71 We also note that three competitors suggested that there were barriers to competition, in particular due to the size of FirstGroup. However, two other competitors indicated that a number of competitors were successfully bidding for contracts, in contrast to the position in 1989.

⁴⁸ In addition, one LTA considered that in general there was insufficient competition for larger contracts.

5.72 We analysed data on tenders by the four LTAs in order to assess the intensity of competition. The analysis indicates:

- (a) In relation to BANES, the number of tenders for supported services has decreased since 2008. During this period, there have consistently been more than five operators actively participating in tenders. In the most recent tender round, there were at least four bidders for each contract. FirstGroup did not win any contracts in 2016/17, in contrast to 2013/14 where it won two out of the three contracts it bid for. Since 2008, over 17 operators have bid for contracts. CT Coaches and Wessex are currently the most significant competitors, each winning 50% of the contracts they bid for in 2016/17.
- (b) In relation to BCC, between three and five operators have participated in each tender, with eight different operators taking part in tenders since 2011. FirstGroup [X]. The four successful bidders and the respective percentage of contracts won by each of them were Abus (13%), CT Plus (50%), Stagecoach (13%) and Wessex (25%).⁴⁹
- (c) In relation to South Gloucestershire, the data we received is subject to some limitations due to its format. We have therefore focused our analysis on more recent years. Since 2012, The South Gloucestershire local authority has been tendering on average 11 routes per year. The evidence suggests that the local authority is not constrained for choice as there are four to six operators actively participating in tenders. Each tender received on average two to three bids. In 2016, FirstGroup participated in 33% of the tenders held while Stagecoach and Severnside submitted bids in the majority of tenders held (83% and 67% respectively). Stagecoach was awarded a combination contract comprising of five routes, a practice that is relatively common for the South Gloucestershire local authority.
- (d) In relation to North Somerset, there has been a significant reduction in the number of tenders from an average of 17 tenders per year in the period 2006-2014 to an average of only three tenders per year between 2015 and 2017. 25 different operators bid for contracts between 2006 and 2017, although in tenders since 2015 there have been no more than two bidders. FirstGroup's share of the LTA's budget fell from 74% in 2014-15 to 27% in 2016-17, with the shares of Carmel and Crossville increasing significantly.

⁴⁹ The percentage of contracts won is calculated with respect to the contracts for which the operator submitted a bid. It is therefore the ratio of successful bids over all bids submitted by the operator.

5.73 In relation to the MMC's second theory of harm, that the loss of City Line as an independent major competitor would weaken competitive tendering, we note that a significant number of new competitors have successfully entered the sector since 1989. The MMC's concern that smaller competitors would not be able to win contracts if bidding against Badgerline no longer appears to apply.⁵⁰

- *FirstGroup's strategy*

5.74 FirstGroup told us that they now tender for fewer contracts in the geographic area of the Undertakings than they did historically. Two LTAs told us that FirstGroup [X] whilst BCC believe that FirstGroup [X]. The assessment of tender data also indicates that FirstGroup is now bidding for fewer tendered contracts in the specified area. In contrast, either Badgerline or City Line (or both) bid for 98% of contracts awarded by Avon County Council in 1988.⁵¹

- *Conclusion on the supply-side*

5.75 We provisionally conclude that the increase in the number of competitors for LTA contracts in the specified area together with the reduction in FirstGroup's bids for contracts is a key factor in leading to a change of circumstance. In itself, the abolition of Avon County Council need not be a major change of circumstance, but it has had a practical effect on the continuity of the Undertakings.

Provisional conclusion on changes of circumstance affecting the MMC's concerns

5.76 We therefore provisionally conclude that there has been a change of circumstance since 1989 in relation to the following:

- (a) A significant reduction in LTA budgets for tendered bus services and, consequently, the commercialisation of many tendered services.
- (b) Changes in the structure of tenders (which may help to facilitate the entry of new bus operators) and the granting of additional powers to LTAs in relation to local bus services.
- (c) The abolition of Avon County Council and replacement with four LTAs and, in addition, the creation of WECA.

⁵⁰ We do not therefore consider FirstGroup's arguments that private transport now exerts a greater competitive constraint on bus services than was the case in 1989 (see paragraph 5.21).

⁵¹ Tables 3.3 and 3.4 of the MMC report.

- (d) The successful entry of a number of competitors since 1989 and a significant reduction in the FirstGroup's market share of tendered services in the specified area. At the time of the MMC report, Badgerline and City Line ran 82% of services. In contrast, in the most recent tender rounds, FirstGroup did not win any contracts in three of the four LTAs, with at least four competitors successfully bidding against FirstGroup in each tender round. In the other LTA, FirstGroup's share of tendered services has fallen significantly. Moreover, FirstGroup appears to have switched its focus away from bidding to operate tendered services in the specified area.

Implications of a change of circumstances for the Undertakings

- 5.77 In this section we summarise the views of FirstGroup, LTAs and competitors about the effects of the Undertakings and their views on whether the Undertakings should be retained or varied. We then set out our assessment of the effects of the Undertakings.

The views of FirstGroup

- 5.78 FirstGroup told us that it was not aware of the Undertakings ever having been enforced or referred to in its dealings with the relevant local authorities which succeeded Avon County Council in 1996. If the Undertakings were to be enforced, FirstGroup told us that complying with the obligation to submit tenders could lead to it incurring costs which would have a negative impact in other parts of their business as well as on LTAs and customers.

The views of LTAs

- 5.79 BANES told us that it was not aware of the Undertakings, potentially due to the splitting of Avon County Council into four local authorities,⁵² and has not enforced the Undertakings.
- 5.80 BCC said that it had not been aware of the Undertakings. BCC told us that it does not see the practice of commercial services being re-registered when FirstGroup loses a tender in Bristol. In relation to the cap on profit in the Undertakings, BCC told us that there is sufficient competition such that it does not overpay for tendered services. [X].

⁵² BANES reported to us, following discussion with ex-Avon County Council colleagues, that the senior officers who transferred from Avon County Council to the four new authorities were aware of the Undertakings and would have been alert to any relevant issues, had they arisen. However, the retirement of such officers, turnover of staff and the lack of any issues on which to challenge has led to a diminishing awareness among current staff that the Undertakings were still in force.

- 5.81 North Somerset told us that it was not aware of the Undertakings. It also believed that the Undertakings were not workable.
- 5.82 South Gloucestershire told us that it was not aware of the Undertakings. South Gloucestershire also said that it could not think of examples of tendered services being re-registered commercially.

The views of competitors

- 5.83 Abus told us that the Undertakings could affect the bidding for any future franchised bus operations.
- 5.84 Rotala said that is not aware of the Undertakings but, having now read their provisions, it considered that FirstGroup had breached the Undertakings. In particular, FirstGroup had opened up commercial routes to compete with contract routes awarded to other operators. For example, in South Gloucestershire, Rotala told us that FirstGroup registered commercial services on 80% of Rotala's tendered routes. Rotala said that this resulted in tenders being withdrawn and Rotala exiting from the routes. Rotala stated that FirstGroup then requested de minimis payments from BCC and South Gloucestershire.
- 5.85 Somerbus submitted that the Undertakings were now not relevant.
- 5.86 RATP told us that if the Undertakings were to be removed, there would still be a need to confirm whether competition in this market is still effective and efficient.

Our assessment of the effects of the Undertakings

- 5.87 We note that all four LTAs told us that they were not aware of the Undertakings. Neither were FirstGroup or its competitors.
- 5.88 No party that we spoke to argued that the Undertakings were having a beneficial effect and should be retained. In our view, this provides strong support for releasing the Undertakings.
- 5.89 We also considered whether the Undertakings, if they were to be enforced in the future, would enhance competition in local bus services in the specified area and improve outcomes for bus passengers. In this regard, we note that:
- (a) In relation to the first element of the Undertakings, the information provided by LTAs and competitors indicates that there were either no or

limited examples⁵³ of FirstGroup deregistering a bus service and, following tendering for a subsidised service, launching a commercial service which substantially duplicates the tendered service.. LTAs also told us that the reduction in funding for tendered bus services reduces the scope for FirstGroup to engage in this practice as deregistered commercial services are less likely to be put out to tender.

(b) In relation to the second element of the Undertakings, LTAs told us that there were sufficient bidders for tendered contracts without FirstGroup. LTAs also said that a price not exceeding 120% of expected direct cost and revenue as required by the Undertakings would be far in excess of the price that they would be prepared to pay for a contract in the current local authority funding environment.⁵⁴

5.90 We note that some competitors expressed concerns about how competition in bus services in the specified area is working. However, our provisional decision is that there has been a change of circumstances such that concerns articulated by the MMC in 1989 no longer apply. Moreover, we note that the purpose of the Undertakings was to restore competition to pre-merger levels and not to address any wider competition issues in tendering for local bus service contracts.

5.91 We provisionally conclude that the Undertakings are not having any effect on competition for tendered contracts in the specified area and that there would be no benefit to competition in retaining the Undertakings in their current form.

5.92 We also consider whether the Undertakings should be varied or superseded. As set out at paragraphs 5.66 to 5.72, FirstGroup's share of tendered bus services in the specified area has reduced significantly since the time of the MMC report. We also note that retaining unnecessary behavioural remedies risks distorting market outcomes.⁵⁵

5.93 We therefore provisionally conclude that there would be no benefit from varying or superseding the Undertakings.

5.94 In light of our provisional findings at paragraphs 5.91 and 5.93 above, we consider the likely impact if FirstGroup were to be released from the Undertakings.

⁵³ A number of the examples involved FirstGroup registering commercial services which compete with tendered services, but did not follow tenders in which FirstGroup had participated.

⁵⁴ LTAs also told us that there were practical difficulties in calculating margins for each contract.

⁵⁵ [Merger Remedies Guidance \(CC8\)](#), paragraph 2.14.

Impact of releasing the undertakings

5.95 We consider what might happen if the Undertakings were to be removed.

5.96 As we provisionally conclude that the Undertakings are not having any effect on competition for tendered contracts in the specified area, we provisionally conclude that there would be no impact on competition from releasing the Undertakings.

6. Provisional decision

6.1 As a result of our assessment, we provisionally conclude that the Undertakings should be released by reason of a change in circumstance.

6.2 In parallel to this provisional decision we have published a notice of intention to release the Undertakings.

7. Consultation

7.1 We are now consulting on this provisional decision. The consultation closes on **Friday 30 June 2017**. Please submit responses to:

Phil James
Project Manager
Competition and Markets Authority
6th Floor East
Victoria House
37 Southampton Row
London WC1B 4AD

Email: remedies.reviews@cma.gsi.gov.uk

7.2 Following this consultation, the CMA will consider the responses received and the evidence and views presented and will assess the impact of these responses on its provisional decision before reaching a final decision. A final decision is expected to be published in Summer 2017.