

<b>Title:</b> Changes to bus service registration requirements relating to frequent services to improve competition in the bus market  <b>IA No:</b> DfT00264  <b>Lead department or agency:</b> Department for Transport  <b>Other departments or agencies:</b> Traffic Commissioners; VOSA	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 16/12/13		
	<b>Stage:</b> Consultation		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Secondary legislation		
<b>Contact for enquiries:</b> Laura Teale, Department for Transport, <a href="mailto:laura.teale@dft.gsi.gov.uk">laura.teale@dft.gsi.gov.uk</a>			
<b>Summary: Intervention and Options</b>			<b>RPC:</b> GREEN

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out? Measure qualifies as
-£0.038m			Yes   Zero net Cost

**What is the problem under consideration? Why is government intervention necessary?**

The local bus market outside of London is deregulated, with competition expected to take place on bus routes. However, a Competition Commission inquiry found that there was insufficient competition in the local bus market, leading to adverse effects of competition such as high fares and poor services. They found that existing rules for registering 'frequent services' (i.e. those that run 6 or more times per hour) allowed operators to flood a route with buses in response to a competitor's entrance to the market without making a registration application to the Traffic Commissioner. This can act as a barrier to entry and expansion into a market. Government intervention is necessary to ensure fair and sustainable competition.

**What are the policy objectives and the intended effects?**

The aim is to reduce the threat of post-entry anti-competitive behaviour by incumbent operators, which deters operators from entering and expanding into a market. Requiring the frequency of buses to be expressed in hourly bands when registering or varying a 'frequent service' means the registration notice periods have to be observed, preventing an incumbent flooding a route in response to a new competitor.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

The Competition Commission considered the need for regulation as part of its inquiry into the market for local bus services. After considering various remedies, they decided simple universal rules were the most effective way of addressing the adverse effect on competition. The following policy options are considered: **Option 1** – regulations requiring operators to register frequency of buses by band in each hour of operation, the default band being 6-8 services per hour, with the next band being 9+.

**Option 2** – regulations requiring operators to register frequency of buses by band in each hour of operation, the default band being 6-8 services per hour. The frequency bands being 6-8, 9-11, or 12+ in each hour. **Option 3** – Introduce regulations requiring operators to register frequency of buses by band in each hour of operation, the default band being 6-8 services per hour. Here, the bands are overlapping i.e. 6-8 services, 7- 9, 8-10, 9-11, 10-12, 11-13, or 12+ in each hour.

Option 2 is the preferred option as it is best placed to improve competition. See page 12 for more details on why it is our preferred option. Operators must give notice of a change of registration if they wish to change service frequency that falls outside of their identified bands. This applies under all of the options considered.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 10/2019					
Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			<b>Traded:</b> N/A		<b>Non-traded:</b> N/A

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister: \_\_\_\_\_ **Baroness Kramer** Date: 10/02/2014

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Introduce regulations requiring operators to register 'frequent services' in hourly bands. Default band would be 6-8, operators would be required to give notice of change of registration if they wish to increase this frequency to 9+.

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.022	High: -0.036	Best Estimate: -0.029

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.020	1	0.0003	<b>0.022</b>
High	0.023		0.0015	<b>0.036</b>
Best Estimate	0.021		0.0009	<b>0.029</b>

### Description and scale of key monetised costs by 'main affected groups'

Transition costs to VOSA in informing operators of the change in regulations. This is split between informing operators of the new system, and responding to queries and changes in registrations<sup>1</sup>. Recurring costs to operators when they vary a services frequency band both in terms of the registration fee and associated administrative costs and recurring administrative costs to VOSA.<sup>2</sup>

### Other key non-monetised costs by 'main affected groups'

Transition costs to operators of informing VOSA which band existing 'frequent services' fall into and for changing IT systems. The scale of the costs is likely to be medium and the least amongst all three options as there is the least amount of choice or complexity compared to the other options. There may be potential to monetise these post consultation. Incumbent operators may lose out as increased competition may reduce their profit margins.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NQ	0	NQ	<b>NQ</b>
High	NQ		NQ	<b>NQ</b>
Best Estimate	NQ		NQ	<b>NQ</b>

### Description and scale of key monetised benefits by 'main affected groups'

No benefits have been able to be monetised at this stage.

### Other key non-monetised benefits by 'main affected groups'

Passengers may benefit from service stability (small benefit), whilst operators may benefit from lower barriers to entry into routes where 'frequent services' operate. This may ultimately benefit passengers in the form of improved competition, better quality bus services and lower fares (large benefit). The benefits for option 1 are likely to be the least for all three options as only one band is introduced; operators who operate more than 9 buses per hour will still be able to act in the same way as before the regulation. There may be potential to monetise these post consultation.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
<p>There is a risk that the regulations increase barriers to entry by reducing the flexibility of operators to immediately respond to changing market conditions. However, short notice registrations will continue to be available and could possibly be used in such circumstances although this is at the discretion of the TC.</p> <p>There is a risk that users of the e-registration service could be required to upgrade their software at a cost in order to continue using the system and so may decide to stop using it, reducing the quality of data given.</p>		

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs:	Benefits:	Net: -	Yes	Zero net cost

<sup>1</sup> High: assumed 5% changes between frequency bands annually. Low: 1% annually. Best: 3% annually.

<sup>2</sup> Sensitivity of 5% cost change each way from VOSA estimate of 18,046.

# Summary: Analysis & Evidence

# Policy Option 2

**Description:** Introduce regulations requiring operators to register 'frequent services' in hourly bands. Default band would be 6-8. Operators give notice of a change to registration if they wish to increase frequency bands. Options are 6-8, 9-11 or 12+

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.034	High: -0.051	Best Estimate: -0.042

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.020	0.0016	<b>0.034</b>
High	0.023	0.0031	<b>0.051</b>
Best Estimate	0.021	0.0023	<b>0.042</b>

### Description and scale of key monetised costs by 'main affected groups'

Transition costs to VOSA in informing operators of the change in regulations. This is split between informing operators of the new system, and responding to queries and changes in registrations<sup>3</sup>. Recurring costs to operators when they vary a services frequency band both in terms of the registration fee and associated administrative costs and recurring administrative costs to VOSA<sup>4</sup>.

### Other key non-monetised costs by 'main affected groups'

Transition costs to operators of informing VOSA which band existing 'frequent services' fall into bands and for changing IT systems. The scale of the costs is likely to be medium and greater than option 1 but less than option 3. There may be potential to monetise these post consultation. Incumbent operators may lose out as increased competition may reduce their profit margins.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NQ	NQ	<b>NQ</b>
High	NQ	NQ	<b>NQ</b>
Best Estimate	NQ	NQ	<b>NQ</b>

### Description and scale of key monetised benefits by 'main affected groups'

No benefits have been able to be monetised at this stage.

### Other key non-monetised benefits by 'main affected groups'

Passengers may benefit from service stability (small benefit), whilst operators may benefit from lower barriers to entry into routes where 'frequent services' operate. This may ultimately benefit passengers in the form of improved competition, better quality bus services and lower fares (large benefit). Passengers will have greater benefit from option 2 than option 1 as operators have less flexibility in their ability to act anti-competitively. There may be potential to monetise these post consultation

Key assumptions/sensitivities/risks	<b>Discount rate (%)</b>	3.5
<p>There is a risk that the regulations increase barriers to entry by reducing the flexibility of operators to immediately respond to changing market conditions. This is more of a risk than option 1 however flexibility is built in within bands which mitigates some of the risk. However, short notice registrations will continue to be available and could possibly be used in such circumstances although this is at the discretion of the TC.</p> <p>There is a risk that users of the e-registration service could be required to upgrade their software at a cost in order to continue using the system and so may decide to stop using it, reducing the quality of data given.</p>		

## BUSINESS ASSESSMENT (Option 2)

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>In scope of OITO?</b>	<b>Measure qualifies as</b>
<b>Costs:</b>	<b>Benefits:</b>	<b>Net:</b>	Yes	Zero net cost

<sup>3</sup>High: assumed 10% changes between frequency bands annually. Low: 5% annually. Best: 7.5% annually.

<sup>4</sup> Sensitivity of 5% cost change each way from VOSA estimate of 18,046.

# Summary: Analysis & Evidence

# Policy Option 3

**Description:** Introduce regulations requiring operators to register 'frequent services' in overlapping hourly bands. Operators are required to give a notice of a change to registration if they wish to change frequency. Bands are: 6-8, 7-9, 8-10, 9-11, 10-12, 11-13, or 12+

## FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2013	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -0.034	High: -0.051	Best Estimate: -0.042

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.020	0.0016	0.034
High	0.023	0.0031	0.051
Best Estimate	0.021	0.0023	0.042

### Description and scale of key monetised costs by 'main affected groups'

Transition costs to VOSA in informing operators of the change in regulations. This is split between informing operators of the new system, and responding to queries and changes in registrations<sup>5</sup>. Recurring costs to operators when they vary a services frequency band both in terms of the registration fee and associated administrative costs and recurring administrative costs to VOSA<sup>6</sup>.

### Other key non-monetised costs by 'main affected groups'

Transition costs to operators of informing VOSA which band existing 'frequent' services fall into and for changing IT systems. The scale of the costs is likely to be high and greatest amongst the three options. There may be potential to monetise these post consultation. Incumbent operators may lose out as increased competition may reduce their profit margins.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	NQ	NQ	NQ
High	NQ	NQ	NQ
Best Estimate	NQ	NQ	NQ

### Description and scale of key monetised benefits by 'main affected groups'

No benefits have been able to be monetised at this stage.

### Other key non-monetised benefits by 'main affected groups'

Passengers may benefit from service stability (small benefit), whilst operators may benefit from lower barriers to entry into routes where 'frequent services' operate. This may ultimately benefit passengers in the form of improved competition, better quality bus services and lower fares (large benefit). The benefits from option 3 are likely to be similar to option 2 as operators are restricted in their ability to change service levels. There may be potential to monetise these post consultation

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
<p>There is a risk that the regulations increase barriers to entry by reducing the flexibility of operators to respond immediately to changing market conditions. Potentially less risk than option 2 as operators choose the direction of their flexibility so should choose based on knowledge, however this is fairly uncertain. However, short notice registrations will continue to be available and could possibly be used in such circumstances although this is at the discretion of the TC. Overlapping bands could make operators incur additional costs through complication and decision making. There is a risk that users of the e-registration service could be required to upgrade their software at a cost in order to continue using the system and so may decide to stop using it, reducing the quality of data given..</p>		

## BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:	In scope of OITO?	Measure qualifies as
Costs:	Yes	Zero net cost
Benefits:		
Net:		

<sup>5</sup> High: assumed 10% changes between frequency bands annually. Low: 5% annually. Best: 7.5% annually.

<sup>6</sup> Sensitivity of 5% cost change each way from VOSA estimate of 18,046.

# Evidence Base (for summary sheets)

## Current Legislation

The arrangements for registration of local bus services are set out in the Transport Act 1985, Section 6 of The Transport Act 2000 and in the Public Service Vehicles (Registration of Local Services) Regulations 1986 (SI 1986/1671) as amended by SI 1988/1879, SI 1989/1064, SI 1994/3271, SI 2002/182 and SI 2004/10 in England and Wales.

The Vehicle and Operator Services Agency (VOSA) who process bus registration applications under delegated authority from the Traffic Commissioners also produced the 'Local Bus Service Registration; Guide for Operators' (PSV 353A) in October 2008 which sets out the requirements for local bus service registration in England. One of the requirements is that an operator must give (in most cases) at least 56 days notice before the start of the service (the '56 day' rule). The 56 day period begins on the day the Traffic Commissioner accepts the registration. The same notification period applies if the operator intends to cancel or change particular services, although in specified exceptional circumstances, services can be registered, cancelled or changed with less than 56 days notice subject to the agreement of the Traffic Commissioner (a 'short notice application').

The regulations require operators to provide the copy of the timetable they intend to operate to the Traffic Commissioner as part of their application. However, where the interval between journeys is 10 minutes or less, the service may simply be classified as 'frequent' and a timetable is not required.

The following sets out the process for registering/changing/cancelling a route is given:

- The operator submits a registration application to introduce, vary or deregister a route to the Traffic Commissioner, and provides a copy to the relevant local authority(ies), at least 56 days prior to commencement.
- When a route is being deregistered or reduced, the local authority spend approximately two weeks analysing the impact and determining if a replacement is necessary.
- When a local authority identifies a replacement service is needed the authority will prepare an emergency contract and invite tendered bids to run the service.

Operators can increase the frequency of a service registered as 'frequent' without needing to submit a registration application to the Traffic Commissioner.

## Background / Problem under consideration

The local bus market outside of London has been deregulated since 1986 with approximately 80% of services operating commercially with the remainder being tendered by local authorities. Competition on commercial services is expected to take place 'on-the-road' where any bus operator can run a service on any route. Operators are expected to compete on fares and service quality. Competition on tendered services takes place 'off-the-road' with operators competing to win contracts to run services from local authorities.

The Office of Fair Trading (OFT) announced on 7 January 2010 that it would be referring local bus services to the Competition Commission (CC). The OFT said it had found evidence that limited competition between operators tended to result in adverse effects on competition (AEC) such as higher prices and lower quality for passengers.

The final report of the subsequent CC market investigation was published on 20 December 2011. In its report, the CC confirmed that there is a lack of sustained head-to-head competition between bus operators in many local markets and also a lack of potential competition. One of the main reasons were:

- There are particular barriers to both new entrants into the market and incumbents that wish to expand into new areas of the market – particularly large-scale expansion – including the threat of retaliatory and predatory behaviour.

Operators of 'frequent' bus services (those that run 6 or more services an hour) do not have to register variations in the frequency of their service (as long as it does not drop below 6 services an hour), and therefore do not need to adhere to the 56 day rule when increasing services. It is the view of the CC that these incumbent operators running 'frequent services' are able to flood routes in response to new

entrants by significantly increasing frequency. Whilst the incumbent makes a loss by doing this, it is able to force the exit of the new entrant (who is unable to compete). Such predatory behaviour raises barriers and limits entry into a bus route, reducing the threat of competition on the incumbent, adversely affecting passengers.

In the view of the CC, the lack of competition in the commercial market can result in a combination of higher fares, fewer services and lower quality services. The CC estimated that, overall, the annual detriment to consumers and taxpayers caused by the lack of competition identified is in the range of £115m to £305m.

In its remedies, the Competition Commission proposed four changes as set out below to the bus service registration requirements to address the AEC which its inquiry had identified. The fourth remedy has been considered in this Impact Assessment, the others are considered in separate ones.

1. Require bus operators to give 14 days notice to a local authority within whose area a bus service is being registered, changed or cancelled, before the application is submitted to the Traffic Commissioner;
2. Require bus operators to give a minimum of 90 days notice (increased from the current 56 days) to the Traffic Commissioner of a change to an existing service registration;
3. Restrict changes to any registration application during any notice period except by making a short-notice application and align the reasons for making short notice applications with those in Scotland;
4. Require bus operators to specify the frequency of services currently registered as 'frequent' (those with six or more journeys per hour).

## Rationale for intervention

It is the view of the CC that the adverse effects on competition from predatory behaviour, is significant enough to justify further government intervention. The local bus market suffers from retaliatory behaviour where incumbent bus operators respond to the entrance of a rival operator by charging excessively low fares (lower than their operating costs), or by creating overcapacity (through increasing frequency), in an attempt to force the rival's exit from the market. The incumbent and rival operators both incur short-term losses until one operator (usually the new entrant) exits the market. The incumbent may also change their timetable to ensure their buses arrive slightly before rival buses, capturing the majority of passengers.

The threat of post-entry retaliation is enough to deter operators from entering or expanding into new markets, and is therefore a barrier to entry. As a result, incumbent operators are able to charge high fares and provide poor services. On the rare occasion a new operator does attempt to compete, there is a short-period of very intense competition that is not sustained, which has a negative impact on passengers who experience service and price instability.

The CC concluded that Government intervention is necessary to ensure that there is sufficient competition on both commercially-operated local bus routes and local authority-tendered routes.

## Policy objective

The main aim of the policy is to reduce the predatory behaviour by incumbent bus operators described above. This is intended to have two effects:

1. Increase competition within the local bus market by reducing entry barriers resulting from predatory behaviour.
2. Improve service stability, benefitting passengers who are negatively affected by unanticipated changes in service frequency.

## Description of options considered

### Using tailored rules to identify inappropriate behaviour

The CC considered whether it would be possible to establish a set of tailored rules to determine the circumstances in which an action by an incumbent operator in response to entry was likely to be inappropriate. However, the CC concluded that there was a significant risk of error in design and of implementation of the rules. As a result, this option was rejected. Instead, simple universal rules were seen as the most effective form of government intervention.

### **Do nothing**

At present operators could significantly increase the frequency of a 'frequent service' so as to flood a route in response to new competition without having to register the variation with the Traffic Commissioner. This behaviour is a barrier to entry and expansion to new or less well resourced operators. The CC report showed evidence of multiple instances where operators flood routes in response to new entrants and forcing them from the market. The do nothing scenario would allow operators to continue to be able to significantly change the number of buses per hour and lead to uncertainty for consumers and potential competitors.

### **Policy options**

The three policy options would all result in an operator having to be more specific about the number of services expected to run under the 'frequent services' category when registering a new service or varying an existing service. An operator would be required to specify which band the service would operate in each hour of the day. Where a service followed a timetable for part of the day and was classed as a 'frequent service' in peak periods the application would have to identify which band(s) the frequent part(s) of the service fell in. For existing 'frequent services' a one-off exercise would be undertaken to identify which band the service falls in, with the default band being 6-8 buses per hour.

If an operator wishes to vary the number of buses outside of the identified band, they would have to comply with the notice periods specified for a change of registration and specify what band they would be moving to.

The legislation implementing this remedy would not be retrospective therefore action needs to be taken to bring all the existing 'frequent service' registrations in line with the new rules. VOSA existing systems are unable to identify which operators currently run services which are wholly frequent or have an element of frequent in the service. Therefore for 'frequent services' registered prior to the amending Regulations coming into force it is proposed that a one-off exercise would be undertaken whereby VOSA would write to all operators requesting that they identify which of the services that they run are classed as frequent and where they operate more frequently than the 6-8 buses per hour default band which band or bands each service falls in. The existing records would then be updated by VOSA staff. Alternatively, VOSA could go through all 22,000 registrations to identify 'frequent services' and then just write to those operators with such services. However, operators have much more knowledge about the types of services that they run and therefore it should be easier and quicker for them to identify their frequent services and which band they fall in and so that is the option proposed.

#### **Policy Option 1**

When registering a new 'frequent service' operators would be required to specify in the application whether the service would operate in the default 6-8 per hour band or 9+. The number of services would not need to be specified in more detail than this. To increase the frequency from 6-8 per hour to 9+ operators would be required to submit a variation application to the Traffic Commissioners and comply with the relevant notice period.

#### **Policy Option 2**

When registering a new 'frequent service' operators would be required to specify in the application which band the service would operate in. The bands would be 6-8 services or 9-11 or 12+ in each hour. To increase or decrease the frequency operators moving into different bands would be required to submit a variation application to the Traffic Commissioners and comply with the relevant notice period.

#### **Policy Option 3**

When registering a new 'frequent service' operators would be required to specify in the application which band the service would operate in. In this case, the bands are overlapping and would be 6-8 services, 7-9, 8-10, 9-11, 10-12, 11-13 or 12+ in each hour. To increase or decrease the frequency operators would be required to submit a variation application to the Traffic Commissioners and comply with the relevant notice period.

#### Transitional costs

As set out above it is proposed that VOSA would undertake a one-off exercise asking operators to identify which of the services they run are frequent and if they do not fall within the 6-8 default band which band they fall in. The costs of undertaking this work would be the same for all options and are set out in detail below.

There would also be a one-off costs applying to all the options. These relate to VOSA having to upgrade its IT system, although as the Regulations are due to come into force in October 2014 it is intended that changes could be integrated as part of VOSA's replatforming of their IT systems due to take place at that time which should minimise or remove these costs. There would also be costs to users of the Electronic Bus Service Registration system. This is because those using the system would need to be able to enter the frequency band within which the service falls. The costs for enabling this would depend on the solution used. A workaround could be introduced using the current system whereby the applicant would have to state in an existing free text box or a separate statement attached to the file which frequency band applies. This would restrict costs to the extra administrative costs of entering the information and costs to VOSA of checking that the information has been supplied. Alternatively, the software could be updated to include a new element for frequency band. Such software is generally part of the scheduling systems supplied commercially by system providers to public transport operators and the timetable databases supplied commercially to local transport authorities. This would result in costs to operators preparing EBSR (Electronic Bus Service Registration) files for submission and local authorities downloading EBSR data who would need to upgrade their software. It is thought the cost could be in the high £tens of thousands or possibly low £hundreds of thousands but this will need to be tested with industry.

## Monetised and non-monetised costs and benefits

Only the administrative costs and benefits have been able to be monetised. VOSA and the CC report have provided the basis for these figures. The monetised costs do not represent the true impacts of implementing the different policy options. The true costs and benefits are expected to be much larger.

### Common costs across all three policy options.

#### Monetised costs

This will be a one off exercise where VOSA would have to contact operators to know which routes are 'frequent services' and whether they lie in the 6-8 or 9+ bands, VOSA would have to cover this extra work through overtime. The cost to VOSA for sending out letters to operators asking for identification and confirmation of change in frequency would be £1900<sup>7</sup>. VOSA would have to deal with the responses from operators, it is estimated that this would cost around £13,485<sup>8</sup> this is likely to be the maximum cost. It is likely that operators would have queries regarding the change in registrations as well as a failure to respond to the letter. This would expect to take up two weeks effort at a cost of £2,661<sup>9</sup>.

#### Non-monetised

The costs for bus operators are less clear than for VOSA. There will be an initial transaction cost for operators who would have to respond to VOSA confirming which of their routes are 'frequent services' and for those routes which band it is in. It is thought the costs would be of a similar magnitude to those experienced by VOSA but could be much higher depending on what resources the operator allocates to

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<sup>7</sup> 1900 operators x £1 per letter

<sup>8</sup> It takes 15 minutes to amend a record so 375 staff hours used to amend 1500 records. Staff costs based on call out charge of £35.96 per hour for an administrative officer (VOSA practise)

<sup>9</sup> Two weeks effort corresponds to 74 staff hours. Staff costs based on call out charge of £35.96 per hour for an administrative officer (VOSA practise). 74 x £35.96 = £2661



dealing with the request. There would also be an ongoing cost to operators of ensuring that any changes to the number of buses per hour on a particular 'frequent service' does not move the service into or out of a frequency band as this would be in breach of the regulations unless an application was made. There could also be additional costs for the users of EBSR as set out above. It has not been possible to monetise these in the pre-consultation IA.

There will be a cost to VOSA whenever operators re-register the band that they are in, however this cost will be offset by the £60 fee they receive from the bus operators.

The costs for VOSA to upgrade the IT system would be in the region of £20,000 - £30,000, however VOSA will be replatforming their IT systems in October 2014, if the change in regulation was brought in for October 2014 the changes could be integrated and costs removed. These costs have therefore not been monetised.

There may be a cost to incumbent operators as there may be more competition in the market. The increased competition may reduce incumbent operator's profit margins. This could have a negative impact on the bus operator as they may have less of an ability to invest or move into new markets.

## **Policy option 1**

### Monetised Costs

Once the regulations are in force, operators who wish to change the frequency of a 'frequent service' to a level that moves it into another frequency band would have to make an application to the Traffic Commissioner and would incur a £60 fee. For option 1, this would only happen when operators change their 'frequent' route from band 6-8 to 9+ or visa versa. This would be additional costs to operators relative to the do nothing scenario.

The net present cost estimated in the best estimate is £28k, for this cost it is assumed that VOSA's estimates for their costs is correct. It has been assumed that 3% of frequent services will have to re-register their band each year as a result of this policy option. This cost is the present value of the transition costs of VOSA informing operators and the present value of costs to operators when re-registering their band. For the low estimate 1% of frequent services have to re-register and costs are 5% less. For the high estimate 5% of frequent services have to re-register and costs are 5% greater.

### Non-monetised Costs

The bands could result in costs to operators and passengers as the bands could prevent operators at the top of the default band responding immediately to an increase in demand, meaning passengers have to endure crowded buses for the duration of the notice period. Or the banding could result in costs to an operator at the bottom of the 9+ band if demand fell as the operator would have to endure the costs of running unprofitable buses, during the notice period until they have successfully registered under the 6-8 band.

As this option is only marginally different to the existing system, costs may not be as significant as those considered under options 2 and 3.

### Monetised Benefits

No benefits have been able to be monetised at this time.

### Non-monetised Benefits

In terms of benefits, passengers may gain from more stability on 'frequent' bus routes. Operators may also benefit from lower barriers to entry into routes that operate 'frequent services', which may in turn benefit passengers through increased competition, lower fares and a higher quality service. However, option 1 may not have the desired benefits as those services which register to be 9+ can still increase supply of buses and flood the market without making a variation application. Hence, it may not fully address the market failure identified in the CC report.

## **Policy Option 2**

### Monetised Costs

Once the regulations are in force, operators who wish to change the frequency of a 'frequent service' to a level that moves it into another frequency band would have to make an application to the Traffic

Commissioner and would incur a £60 fee. As there is less flexibility in option 2 compared to option 1, there would be greater recurring costs for operators under option 2 than under option 1. This would be additional costs to operators relative to the do nothing scenario.

The net present cost estimated in the best estimate is £38k, for this cost it is assumed that VOSA's estimates for their costs is correct. It has been assumed that 7.5% of frequent services will have to re-register their band each year as a result of this policy option. This cost is the present value of the transition costs of VOSA informing operators and the present value of costs to operators when re-registering their band. For the low estimate 5% of frequent services have to re-register and costs are 5% less. For the high estimate 10% of frequent services have to re-register and costs are 5% greater.

#### Non-monetised Costs

The bands could result in costs to operators and passengers as they could prevent operators at the top of a band responding immediately to an increase in demand, meaning passengers have to endure crowded buses for the duration of the notice period. Or could result in costs to an operator at the bottom of a band if demand fell as the operator would have to endure the costs of running unprofitable buses, during the notice period until they have successfully registered under a new band.

The costs are expected to be greater for option 2 than option 1 as the option is more complex.

#### Monetised Benefits

No benefits have been able to be monetised at this time.

#### Non-monetised Benefits

In terms of benefits, passengers may gain from more stability on 'frequent' bus routes. Operators may also benefit from lower barriers to entry into routes that operate 'frequent services', which may in turn benefit passengers through increased competition, lower fares and a higher quality service. The benefits for passengers are likely to be greater under option 2 than under option 1 as operators are more restricted in their anti-competitive behaviour as only those services greater than 12 per hour can flood the market without making a variation application.

The reduced barriers to entry may allow for an environment that can sustain competition. This may either encourage new operators to enter the market or make incumbent operators act competitively to discourage new competitors from joining. Both of these effects may have the outcome of improving competitive nature of the bus market.

### **Policy Option 3**

#### Monetised Costs

Once the regulations are in force, operators who wish to change the frequency of a 'frequent service' to a level that moves it into another frequency band would have to make an application to the Traffic Commissioner and would incur a £60 fee. There is less flexibility in option 3 compared to option 1, but more flexibility compared to option 2. There would be greater recurring costs for operators under option 3 than under option 1. This would be additional costs to operators relative to the do nothing scenario.

The net present cost estimated in the best estimate is £38k, for this cost it is assumed that VOSA's estimates for their costs is correct. It has been assumed that 7.5% of frequent services will have to re-register their band each year as a result of this policy option. This cost is the present value of the transition costs of VOSA informing operators and the present value of costs to operators when re-registering their band. For the low estimate 5% of frequent services have to re-register and costs are 5% less. For the high estimate 10% of frequent services have to re-register and costs are 5% greater.

These costs are likely to be higher for VOSA because of the increased complexity of the overlapping band system, especially confusion and making the options clear to operators.

#### Non-monetised Costs

If a service runs 7 or more buses per hour, option 3 allows more operators to choose which band they are in. Therefore operators can choose a band based on their preferences and objectives. As operators have a choice of band, the one off exercise is likely to be more labour intensive on bus operators.

An operator's choice of band affects their ability to adjust to demand. For example, if an operator runs 9 buses per hour, they have a choice of bands: 7-9, 8-10, or 9-11. If they choose band 7-9 and demand increases, they are unable to instantly run 2 more buses an hour which they would be able to do if they

were in band 9-11. Likewise if they were in band 9-11 and demand fell, they would have to endure the costs associated with a lack of demand, during the notice period until they have successfully registered under a new band. This introduces an element of gamesmanship into the decision making process and a level of risk on the part of operators. It is not possible to monetise this at the pre-consultation stage.

There may be a cost to passengers when operators cannot adjust to demand as quickly as they would have done if the regulation was not bought in.

#### Monetised Benefits

No benefits have been able to be monetised at this time.

#### Non-monetised Benefits

In terms of benefits, passengers may gain from more stability on 'frequent' bus routes. Operators may also benefit from lower barriers to entry into routes that operate 'frequent services', although the benefits are likely to be less than under option 2 as operators chose the direction of flexibility. This may in turn benefit passengers through increased competition, lower fares and a higher quality service. Operators have a choice of bands to choose from so can choose according to their preferences.

## Rationale for and evidence behind analysis

Currently, the evidence behind the costs of the policy has been provided by VOSA, though these are rough estimates. The costs are highly dependent on the precise mechanics and rules of the policy, and therefore can not be monetised until these have been finalised. As the mechanics of the policy have currently been left open to consultation, the costs have not been detailed or monetised.

The current level of analysis has only identified the main stakeholders affected by the policy and whether they will incur a cost or benefit from the policy. Where possible, the scale of the cost has been described. However, as this is a consultation stage impact assessment and a lot of the details of the policy are yet to be decided, it has been deemed disproportionate to request detailed cost estimates from operators and VOSA.

## Risks and assumptions

There is a significant risk that operators may act with more gamesmanship if option 3 was to be implemented. Operators will be initially set into band 6-8; if they wish to change bands then they have a large selection of bands to choose from. The choice of band will indicate how flexible operators are in adjusting to changing market conditions. If they are risk averse they may choose their band where their frequency is at the top the opposite if they are risk takers.

Due to the varying levels of complexity of bands in the different options in each option a different percentage of operators will change their frequency bands per year. It was assumed that a small percentage of operators would change their frequency bands annually. Due to the simplicity of option 1 and the maximum band being 9+, it has been assumed that the range of % services affected would be less than under options 2 and 3. Option 2 and 3 are assumed to be same to each other as it is unlikely operators would change frequency bands any more under policy options 2 or 3. From this we have assumed that there will be a small number of changes in frequency annually for option 1 but more for option 2 & 3. Thus our best estimate option 1 is that 3% of frequent services would change their frequency each year. For options 2 and 3, the best estimate assumes that 7.5% of frequent services change annually as a result of the introduction of frequency bands.

The low, high and best figures used in this IA for percentage of services affected have been based on the logic outlined above. The figures are based on those assumptions but are not based on any data the Department has received. The figures can be updated if, during consultation, the department receives more information on this.

There is a risk that users of the e-registration service could be required to upgrade their software at a cost in order to continue using the system and so may decide to stop using it, reducing the quality of data given.

It has also been assumed that fee (£60) VOSA receives when operators re-registering routes will cover the costs to VOSA of undertaking the re-registration.

It has been assumed that the £60 fee that VOSA charges to operators to change their registration will, in the future, remain to cost £60 in 2013 prices. Therefore no adjustments have been made with respect to inflation.

## One-in, Two-out

This IA is in the scope of OITO as it is changing the regulation bus operators have to adhere to when making registration changes in particular short notice applications.

There are direct costs that would be a burden to operators as a result of this, therefore this IA would be included as an IN within the scope of OITO. However, section 1.9.14 of the Better Regulation Framework Manual July 2013 state that “Measures which increase competition can reasonably be expected to drive economic growth and benefit society. Therefore, where such measures are primarily intended to promote competition, any impacts related specifically to the competition aspects of the proposals should be scored as a zero net cost for the purposes of OITO. “ To qualify as a pro-competition measure the regulation must answer positively to the four questions which are addressed in Annex 2. This demonstrates that positive answers are given in relation to each of the criteria for the whole proposal. Therefore, this measure should be classed as a Zero Net Cost measure for OITO purposes.

## EANCB

As the Department believes that it falls within Pro competition criteria set out in the Better Regulation Framework Manual July 2013, the EANCB has not been calculated. Two costs have been monetised in the IA the initial Admin costs to VOSA and the costs to operators when re-registering their frequency bands. The costs to VOSA do not fall under the scope of EANCB. The monetised costs to operators are being introduced as a result of trying to prevent anti-competitive behaviour and thus improve competition in the bus market.

## Wider Impacts

### Competition Assessment

The policy is intended to reduce the barriers to entry into a bus route where a ‘frequent service’ operates. It does this by preventing incumbent operators from making immediate changes to service frequency in response to entry into the market. It prevents the incumbent from flooding the bus route with higher frequencies, reducing the profitability of the entrant (whilst incurring losses themselves) and thus forcing the entrant’s exit from the market.

However, there is a chance that the new rules, which forces operators of ‘frequent services’ to give 56 days notice in the event of a change in frequency band, will reduce the flexibility of the operator to respond to a change in market conditions. Additionally, it may perversely raise the barriers to entry by delaying an entrant’s ability to change the service frequency by 56 days after entering the market. Should the entrant incur a loss at the original frequency, they would be forced to incur those losses for 56 days before being able to change the frequency to better match market demand. This may increase the risk and therefore raise the barrier to entry into the market.

However in such circumstances, short notice registrations which allow shorter notice periods than the standard 56 days, at the discretion of the traffic commissioner, which could enable operators to make timely changes to frequency for legitimate reasons.

### Small and Micro Business Assessment

There are no plans to exempt small operators as the CC recommended universal rather than tailored rules to secure the competition benefits. Our understanding is that the majority of ‘frequent’ bus services are run by large firms who have sufficient resources to operate at least 6 buses an hour and therefore small and in particular micro firms are unlikely to be affected.

## **Environmental impacts**

### **Greenhouse gas assessment**

These proposals are not intended to have any effect on the number of bus services and therefore we do not anticipate any effect on greenhouse gas emissions.

### **Wider environmental issues**

As above

## **Social impacts**

### **Health and well-being**

Having reviewed the screening questions for the Health Impact Assessment we have concluded that there is no need for a full assessment to be carried out.

### **Human rights**

We do not consider that these proposals will impact on human rights legislation.

### **Justice system**

These proposals do not create any new sanctions or amend existing ones so we do not consider there to be an impact on the justice system.

### **Sustainable development**

We do not consider these proposals to impact on sustainable development.

## **Summary and preferred option with description of implementation plan**

In its remedies, the Competition Commission proposed four changes as set out below to the bus service registration requirements to address the AEC which its inquiry had identified. The fourth remedy has been considered in this Impact Assessment, the others are considered in separate ones.

1. Require bus operators to give 14 days notice to a local authority within whose area a bus service is being registered, changed or cancelled, before the application is submitted to the Traffic Commissioner;
2. Require bus operators to give a minimum of 90 days notice (increased from the current 56 days) to the Traffic Commissioner of a change to an existing service registration;
3. Restrict changes to any registration application during any notice period except by making a short-notice application and align the reasons for making short notice applications with those in Scotland;
4. Require bus operators to specify the frequency of services currently registered as 'frequent' (those with six or more journeys per hour).

The changes are required to ensure that there is fair and open competition in the bus market for operators of all sizes. Changes to regulations are necessary because the registration process is set out in legislation. It would not be appropriate to waive the requirements for small businesses as the regulations are necessary to allow fair competition between operators of all sizes and provide safeguards to passengers. However, the majority of 'frequent' bus services are likely to run by large firms and therefore small firms are unlikely to be affected.

The remedies are intended to work together as a package and we therefore intend to introduce them at the same time, in October 2014.

Our preferred option is policy option 2. We believe it is likely to address the market failure identified by the CC to a greater extent than the other two options. Option 2 should provide more protection to a new entrant than option 1 as it prevents an incumbent operator already running 6 to 11 buses from immediately flooding a service with additional buses in response to competition from a new entrant, as the incumbent operator would need to make a variation application and comply with the relevant notice periods. Whereas, under option 1 operators already running 9 services would still be able to flood the

route without recourse to the Traffic Commissioner. Despite costs to operators being higher under option 2 than under option 1, the benefits are likely to be far greater.

Whilst option 3 also provides greater protection to new entrants from an incumbent operator flooding the service than option 1, the ability for operators to choose from a variety of bands could lessen this protection compared with option 2. This is because the ability to choose the frequency band in option 3 could introduce an element of gamesmanship. There is a chance that operators could choose their band on the basis of being able to increase bus frequency by 2 (i.e. go from bottom of a band to the top). Although this is not a significant increase in bus frequency, it could mean there would be less of an improvement in competition under option 3 than under option 2 where an operator can only select the band based on the frequency of the service.

Option 2 should also be easier to understand and administer, for both operators and VOSA, than option 3, as it would be easy to identify which band a service falls in. Under option 3 operators are likely to spend more time in deciding which band they want to fit into. Due to the increased complexity of the overlapping band system more detailed guidance is also likely to be needed. The longer time needed to understand the complex banding system and to decide the best band to select under option 3 is likely to result in greater costs than option 2.

# Annexes

## Annex 1: Post Implementation Review (PIR) Plan

We will include a clause in the amended regulations to review the effect of the changes to the bus service registration requirements after five years (October 2019). This is in accordance with the Government's broader policy on reviewing new regulation. The Government has undertaken to include clauses in new regulations so that regulatory measures are reviewed regularly to ensure that they are still needed and are not imposing disproportionate burdens.

The Department will carry out a review of these Regulations and set out the conclusions of the review in a report which will be published. The report will set out the objectives which the changes established by the Regulations to the regulatory system were intended to achieve, assess the extent to which those objectives have been achieved, and whether they remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.

## Annex 2: Pro Competition Criteria

The intention of introducing this regulation is to improve competition in the bus market. This will be done by restricting the ability of operators to act anti-competitively. The Better Regulation Framework Manual July 2013 state that impacts specifically related to the competition aspects of the proposal can be scored as zero net cost for the purposes of OITO. To qualify as a pro-competition measure the regulation must answer positively to the following four questions.

**i. Is the measure expected to promote competition? Promoting competition can be achieved through any of the following mechanisms:**

- **Directly increasing the number or range of sustainable suppliers**
- **Indirectly increasing the number or range of sustainable suppliers**
- **Strengthening the ability of suppliers to compete**
- **Increasing suppliers' incentives to compete vigorously**

It is intended that this measure will promote competition by strengthening the ability of suppliers compete. Currently, an operator's ability to compete is often restricted by anti-competitive behaviour of other operators. This happens when operators flood routes by significantly increasing service levels with the intention of removing competitors from the market. Operators incur the short term loses associated with this type of behaviour as in the long run they may be able to gain monopoly profits in an area. By restricting operators ability to do this, competing operators may be able to mature their routes and compete more successfully in the bus market.

**ii. Is the net impact expected to be an increase in competition (i.e. if a policy fulfils one of the criteria but results in a weakened position against another)?**

Yes, it is expected that through preventing operators from flooding routes, other operators may be able to compete. This may prevent bus wars from occurring.

Currently, some operators will increase the level of service for a short period of time to drive competition from the market, in the short term passengers benefit as they have frequent service. In the long run those operators cease to operate as many services and thus passengers have less choice of service than previously. The intention of this regulation would be to prevent operators from significantly increasing service levels without re-registration of the service. Reducing such barriers to entry is expected to increase potential competition.

A consequence of the policy is that operators will be slower at responding to changing market conditions; this could have an effect on the competitiveness of the bus industry, however this should be outweighed by the gains in ability to compete.

**iii. Is promoting competition the primary expected impact of the policy?**

Yes, the main intention of this IA is to prevent the ability of operators to flood routes and act anti-competitively. The Office for Fair Trading recommended the bus industry to the Competition Commission due to the anti-competitive behaviour of firms. This IA is based the recommendations provided by the Competition Commission report, which are all aimed at increasing competition in the bus market.

**iv. Would it be reasonable to expect a net social benefit from the policy (i.e. benefits to outweigh costs), even where all the impacts may not be monetised?**

It is expected that there will be a net social benefit from the policy. New entrants should be able to enter the market as predatory behaviour from incumbent bus operators will be curbed. The curbing of predatory behaviour may result in fewer bus wars and thus this should benefit customers in the long run.

We expect the benefits to society to be greater than the costs. Currently, when operators flood the market, passengers are unaware of when buses will arrive and also may suffer as buses tend to skip stops. Operators may benefit through knowing other operators routes and not wasting resources running bus wars when other operators will be.