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Competition Commission Bus Market Investigation

**Response to provisional decision on remedies**

October 2011

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Jonathan Bray  
Director

*pteg* Support Unit  
Wellington House  
40-50 Wellington Street  
Leeds – LS1 2DE  
0113 251 7445  
info@pteg.net

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## 1. Introduction

- 1.1. **pteg** represents the six English Passenger Transport Executives (PTEs) in England which between them serve more than eleven million people in Tyne and Wear, West Yorkshire, South Yorkshire, Greater Manchester, Merseyside and the West Midlands. Leicester City Council, Nottingham City Council, Transport for London (TfL) and Strathclyde Partnership for Transport (SPT) are associate members of **pteg**, though this response does not represent their views.
- 1.2. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of delivering integrated public transport networks accessible to all. The PTEs are responsible to Integrated Transport Authorities (ITAs) made up of locally elected representatives from their constituent local authority districts.
- 1.3. Bus networks are of critical importance in the metropolitan areas. Over 1 billion bus trips were made across the six PTEs in 2009/10, representing 37% of the bus market in the area covered by the Competition Commission's investigation.

## 2. Summary of key points

### Overview

- 2.1. The Competition Commission's (CC) Provisional Decision on Remedies (PDR) represents a significant and fundamental change in direction from previous CC reports with the emphasis now on encouraging on-street competition. The reasoning behind this change of direction is not explained.
- 2.2. The three weeks the Competition Commission has given us to respond to this significant change in direction is inadequate (particularly for federated bodies) given the overall timescales for the process, and the slippage by the CC in meeting its own deadlines. Nevertheless, we have sought to provide as comprehensive a response as possible.
- 2.3. Overall we do not share the view that promoting on-street competition (or maintaining the conditions that would allow for the theoretical possibility of future on-street competition) should be the primary driver of bus policy or that they will address the root causes of the Adverse Effect on Competition (AEC) and its detrimental effect on bus passengers.
- 2.4. In our view the CC's latest position ignores much of its earlier analysis and seems to be based more on assertion rather than evidence. We note that the CC's provisional findings recognised that stable on-street competition is not necessarily likely to arise in the deregulated bus market <sup>1,2</sup> (*"our provisional finding is that head-to-head competition tends towards instability the closer the competition between operators becomes"*<sup>3</sup>) and the draft remedies do not explain why, and on what basis, the CC has changed its view.
- 2.5. We welcome the CC's conclusion that the detrimental effect on consumers of the AEC could amount to as much as £150m per year. However we believe that the AEC is still under-estimated by ignoring the impact of the AEC on other UK markets.
- 2.6. Although some of the measures set out in the report do have the potential to bring benefits (particularly relating to ticketing) the report does not present a case for how the individual measures will combine effectively as a package over a realistic timescale, or for the cumulative benefits of the individual measures. This absence of evidence means that we do not see how the CC can substantiate its claims that its overall package of remedies will achieve a comprehensive solution to the AEC, in particular as it does not seem capable of addressing the significant degree of concentration present in many areas.

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<sup>1</sup> Paragraph 39 of Summary of Provisional findings: "We found that there were factors in the market which tend to make head to head competition unstable".

<sup>2</sup> Para 41 of Summary of Provisional findings: "(...) competition can result in a costly period of rivalry between operators which is likely to be loss-making, and so culminate in the exit of one operator. This occurs because both operators have an incentive to increase the number of services to attract more passengers from their rivals, leading to oversupply on the route. (...) While these actions can be beneficial to consumers, they can sometimes be extreme in order to weaken rivals, and tend to persist only in the short term". We would argue that this instability is not in itself beneficial to consumers as demonstrated by White's (1990) welfare analysis of the post deregulation period in metropolitan areas.

<sup>3</sup> Paragraph 42 of Summary of Provisional findings

- 2.7. By extension we cannot see how the CC has concluded that the package of measures it presents is superior to alternative remedies, in particular the provisions for Quality Contracts which Parliament approved in the Local Transport Act 2008.

### **Ticketing**

- 2.8. The measures set out in the report on multi-operator ticketing have the potential to bring benefits and are therefore welcome. However, the CC seems to have significantly under-estimated the costs of their introduction and the practical implementation challenges of these remedies. Implementing the CC's full package of measures on ticketing would also require primary legislation which, with associated guidance and lead in time for implementation on the ground (given the complexity of the issues involved and past opposition from operators). This means that we believe the CC has also significantly underestimated the time it would take to implement these measures across the study area.

### **Partnerships**

- 2.9. We do not accept that the primary benefit and objective of partnerships is that they offer the theoretical possibility of greater on-street competition. The experience of partnership working hitherto does not suggest that partnership working results in greater competition, and we can see no reason why the relatively modest measures proposed in the report will ensure that in future partnerships will result in more on-street competition.
- 2.10. Following on from the Local Transport Act 2008 significant progress has been made in implementing high end voluntary partnerships, Statutory Quality Partnerships and Qualifying Agreements. These are bringing real benefits for passengers right now. The approach the CC takes in this report threatens to turn the clock back by raising the same vague but threatening doubts over the value of any scheme that excludes the theoretical possibility of low end competition. This is the approach that inhibited partnership working prior to the Local Transport Act 2008, and was unsuccessful in its own terms, in that it did not succeed in achieving the greater degree of on-street competition that the CC is seeking.

### **Franchising**

- 2.11. The report over-estimates the risks and costs of franchising whilst failing to make any recommendations on how those costs and risks could be addressed.
- 2.12. The appearance of the ambiguous phrase „significant market failure“ in relationship to Quality Contract appears in isolation and is not justified by argument or rationale in the supporting text or appendices, nor is it part of the process that Parliament approved for Quality Contracts. We argue that it should therefore be removed in the final report as the CC has presented no justification for its inclusion.
- 2.13. Overall there is a danger that the CC's ambivalence and vague disapproval of both franchising and high end partnerships (including SQPs and Qualifying Agreements) will:
- open the way for selective reading by different interest groups;

- [✂];
- [✂].

## **BSOG**

2.14. BSOG could potentially be used to incentivise positive outcomes on areas like ticketing, however there would be a considerable amount of work to do before it would be clear whether such incentives would be effective, and how they would be administered and validated on a national scale in pursuit of finely calibrated and uniquely local circumstances. There are also potential legal hurdles in relation to EU Competition Law which ironically the Competition Commission appears unaware of. Overall BSOG would be better utilised through devolving it in a ring-fenced way so that PTEs could target it effectively in line with local circumstances and objectives which could include incentivising positive outcomes on ticketing and information.

### 3. Response structure

Sections 3 to 5 cover our view on the role of on-street competition in bus markets, on the impact of changes to bus markets on other relevant UK markets and on the estimation of the detrimental effect of the AEC.

- 3.1. Sections 6 to 12 address each of the proposed CC remedies of relevance to PTEs.
- 3.2. Section 13 provides our assessment of whether the proposed package of remedies is likely to provide a comprehensive solution to the AEC identified.
- 3.3. Section 14 provides our response to the CC's assessment of the franchising remedy.

### 4. The risks of on-street competition

- 4.1. In our view, the CC's provisional decision on remedies signals a sea-change regarding the potential for on-street competition in the bus market, which ignores much of its own earlier analysis and conclusions.
- 4.2. The provisional findings recognised that stable on-street competition is not necessarily likely to arise in the deregulated bus market<sup>4,5</sup> (*"our provisional finding is that head-to-head competition tends towards instability the closer the competition between operators becomes"*<sup>6</sup>). In addition, it was stated that *"where sustained examples of head to head competition exist there is usually some degree of differentiation of service provision that both facilitates sustained competition but also may weaken its impact"*<sup>7</sup>.
- 4.3. In contrast with this previous position, the CC now assumes that on-street competition is desirable and will emerge on a sustainable basis without the need for any fundamental changes to the current market structure or the underlying regulatory framework.
- 4.4. In addition, the CC appears so confident in the effectiveness of its proposed remedies to willingly undermine some of the current regulatory tools available to LTAs, which, in our view, have been critical in curbing some of the detrimental effects to consumers of the current market structure:
  - On the one hand, the CC now appears ambivalent about the role that partnerships have played in mitigating the worst excesses of competition and ensuring passengers get a higher quality of service at a lower price.

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<sup>4</sup> Paragraph 39 of Summary of Provisional findings: "We found that there were factors in the market which tend to make head to head competition unstable".

<sup>5</sup> Paragraph 41 of Summary of Provisional findings: "(...) competition can result in a costly period of rivalry between operators which is likely to be loss-making, and so culminate in the exit of one operator. This occurs because both operators have an incentive to increase the number of services to attract more passengers from their rivals, leading to oversupply on the route. (...) While these actions can be beneficial to consumers, they can sometimes be extreme in order to weaken rivals, and tend to persist only in the short term". We would argue that this instability is not in itself beneficial to consumers as demonstrated by White's (1990) welfare analysis of the post deregulation period in metropolitan areas.

<sup>6</sup> Paragraph 42 of Summary of Provisional findings

<sup>7</sup> Paragraph 55 of Summary of Provisional findings

- On the other, the CC rules out the need to recommend the introduction of franchising as a way to address the persistent absence of effective competition in some areas.

- 4.5. Even if the limited set of remedies proposed were to produce a material change in some less concentrated markets it seems at best optimistic to expect that they will make a change everywhere. The CC's own analysis classifies close to three quarters of all urban areas in the reference area as either '*near monopoly*' or '*near duopoly*'. These are areas where there is little or no meaningful competition at present and where we would not expect to see competition in the future without fundamental changes to the existing market structure or the local regulatory framework.
- 4.6. Overall it appears that in its latest report the CC has returned to the safe and familiar haven of the theoretical benefits of on-street competition. In doing this it seems to have disregarded much of its own earlier analysis and the overwhelming evidence from the post-deregulation period. Metropolitan areas had seen stable patronage for the five years preceding deregulation, whereas five years on from deregulation patronage had declined by a quarter<sup>8</sup>. White (1997) has shown that a substantial proportion of this decline was due to the high degree of service instability that resulted from the initial high degree of on-street competition in many areas.
- 4.7. In our view, this change in focus has taken place without the CC presenting a convincing rationale for why the benefits of on-street competition will deliver significant consumer benefit, why its proposals will result in more on-street competition in the first place, and why it is so convinced that even in the event that its proposals were to result in more on-street competition that this possibility merits casting doubt over existing and proven tools for improving bus services.

## 5. The impact of bus services on other consumer markets

- 5.1. The CC recognises the relatively narrow remit of its investigation while acknowledging that LTAs and the DfT have much wider roles and responsibilities. We partly agree with this view and would emphasise that the bus policy review that will follow the CC's investigation will need to take a much broader perspective.
- 5.2. However, we would wish to point out that the CC's statutory responsibility to "(...) *achieve as comprehensive a solution as is reasonable and practicable to the AEC and any **detrimental effects on consumers***"<sup>9</sup> refers, not only to bus passengers and potential bus passengers, but to **any consumers in relevant UK markets**. We would therefore argue that the CC's remit does coincide with some of the 'wider policy objectives' of LTAs, in particular relating to the reduction of congestion, access to labour markets, retail and facilities, and economic growth. We therefore feel it's appropriate to highlight some of these wider objectives which the CC may wish to take into consideration.
- 5.3. Bus networks provide a vital connection to jobs, services and facilities for the 33% of households in metropolitan areas who do not own a car and who make up the majority of bus passengers. For the remaining two-thirds of households, bus networks play two key roles: they allow households to minimise their outlay on private transport and they

<sup>8</sup> DfT Bus Statistics

<sup>9</sup> Enterprise Act 2002

have a positive effect on the degree of congestion, and hence travel time and fuel costs, suffered by road users.

- 5.4. Our analysis shows that public transport accounts for more than half of all morning peak trips into the largest city centres in England. If all these trips were to be made by car, traffic levels would double, cities would grind to a halt and the cost of travel would increase dramatically for both households and businesses. Based on the Department for Transport's transport analysis guidance (WebTAG) we estimate that the annual decongestion benefits of bus travel in PTE areas alone amounts to in excess of £400m. Given that the AEC will reduce the attractiveness of bus networks, these external effects on consumers in other markets should be recognised in the CC's estimate of the level of detriment identified (in accordance with the Enterprise Act 2002).
- 5.5. The arguments above imply that even in the unlikely event that on-street competition does indeed materialise throughout the study area, this may not result in the best outcome for consumers as a whole unless it contributes towards an increase in passenger demand. As highlighted in the previous section, the deregulation of metropolitan bus markets and the ensuing period of intense on-street competition led to a 25% reduction in bus patronage in the PTE areas.

## 6. Estimating the detriment from the AEC

- 6.1. While we welcome the CC's decision to widen its analysis to encompass the impact of the AEC on consumer welfare we have reasons to believe [X]. Our implementation of what we understand to be the methodology proposed by the CC leads to a much higher level of AEC than the lower bound quoted in table 4 of appendix A.
- 6.2. We would also note that the results appear to be relatively sensitive to the assumed demand elasticity, which we believe differs from long term values which are well established in the literature.
- 6.3. We would also wish to point out that the CC's estimates exclude the external effects on other UK markets of changes in the bus network, in particular relating to road congestion, accidents and environmental effects. According to the Enterprise Act 2002 these should be taken into account by the CC and there are a range of easily available tools to do as part of the DfT's WebTAG guidance.
- 6.4. We would welcome the opportunity to discuss these points further with the CC.

## 7. Ticketing remedy

**The measures relating to multi-operator ticketing have the potential to generate benefits and are therefore welcome. However, the CC seems to have significantly under-estimated the costs and practical implementation challenges of its proposed remedies. Implementing the CC's full package of measures on ticketing would require primary legislation, which, with associated guidance and lead-in time for implementation on the ground means that we believe the CC has also significantly under-estimated the implementation timescales.**

- 7.1. The PTEs share the Competition Commission's conclusion that the network economies that result from incumbent operators' ability to offer attractive discounted tickets can

create a barrier to entry for smaller operators. Our own experience suggests that large operators can, and often do, manipulate the availability, promotion and price of MTCs (multi-operator tickets) in order to maximise the market share of their own discounted products, hence reducing the ability of smaller operators to compete for significant segments of the market.

- 7.2. The greater the proportion of frequent passengers and those requiring multi-leg trips to reach their final destination, the greater will be the degree of market power this will potentially confer on the incumbent. We would therefore suspect the related detrimental effect to be most severe in the largest urban areas.
- 7.3. We therefore welcome the set of related remedies which the CC has put forward, in particular:
- Changes to voting mechanisms relating to the management of MTC schemes, shifting greater power towards LTAs and smaller operators
  - Introduction of greater spatial disaggregation of MTC products, potentially including extended travel to work areas
  - Expansion of MTC ticket types available, potentially covering issues such as time availability and corridor-specific return tickets
  - Requirement that MTCs be marketed and sold on an equal footing with single operator tickets, including on-bus
  - Introduction of a standard formula for setting the price of MTC products
  - Revision of the Ticketing Block exemption so as to allow the introduction of more sophisticated revenue sharing arrangements than the existing “*revenue lies where it falls*” principle
  - Clarification by the OFT of the competition law provisions with respect of e-purse smart products.
- 7.4. We agree that, if supported by appropriate legislation, this set of measures could make a significant contribution towards a more level playing field and, ultimately, a more contestable market. In addition, we consider that there could be some additional benefits to passengers if these measures led to lower prices and greater fare certainty and simplicity.
- 7.5. However, we also acknowledge that there are a number of barriers and potential risks which could limit the effectiveness of this remedy as a market opening measure.

### **Potential effectiveness of the proposed remedy**

- 7.6. We note that the CC does not provide an explicit estimate of the expected impact of this remedy on the level of detriment identified. However, given the much more limited scope of the remaining remedies, we conclude that the CC will expect this remedy to have the greatest impact on the AEC.
- 7.7. In order to understand whether this is likely to be realistic it's important to put the remedy into context. Operators already receive a substantial proportion of their revenues<sup>10</sup> in relation to passengers carried and vehicle mileage, through

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<sup>10</sup> We estimate this to be in excess of 30% for non-tendered bus operations in PTE areas

concessionary travel reimbursement and BSOG. Together with multi-operator tickets<sup>11</sup> and singles<sup>12</sup>, this makes for around 65%-70% of total revenues, which means that a large proportion of operating revenues is effectively contestable already. It's therefore arguable whether even a substantial increase in the take-up of multi operator tickets would be sufficient to remove the AEC identified in the current context.

### Implementation timescales

- 7.8. We note that, pending legislative change, LTAs are encouraged by the CC to seek to implement some of the proposed measures through voluntary agreements with operators. However, LTAs already have the powers to introduce most of these measures, in agreement with operators, as set out in the Local Transport Act 2008. Given that several LTAs have already attempted, and failed, to introduce some of these measures due to opposition from operators, it's unlikely that this remedy could be implemented without further statutory powers.
- 7.9. At the same time, the process for parliamentary legislation can be extremely protracted. As annex one of our response shows the time taken from initial consultation through to enactment of the associated orders on the last major piece of buses legislation (the Local Transport Act 2008) was two years and nine months. This does not include the time taken to find a parliamentary slot in the first place (and it is our understanding that this could prove difficult for any new buses legislation) and for the take up of the measures by operators and local transport operators. It would not be unreasonable to assume therefore that it could take five years or more for the effects of the CC's recommendation that require primary legislation to be fully felt. It is therefore our view that the CC may have severely under-estimated the timescales required for the effects of this remedy to be felt.

### Increased ticketing complexity

- 7.10. In some circumstances, the replacement of more complex fares structures with simpler fare structures could lead to an overall improvement in welfare, in particular where the removal of barriers to public transport use from simplification would outweigh the financial dis-benefit to a sub-set of existing users<sup>13</sup>. A review of a number of international examples where simplified ticketing was introduced shows that this can contribute to significant patronage growth (Booz, 2009). This is also supported by recent work for the DfT (Aecom, 2009), which suggests that passengers are willing to pay up to an additional 14p per trip for simpler fares and 46p per trip for a fixed fare structure.
- 7.11. We need to emphasise that it is of critical importance for the overall competitiveness of public transport networks that any changes to fare structures do not result in substantial added complexity for customers. Should this be the case, the loss of welfare from greater disaggregation of multi-operator tickets would reduce the effectiveness of the proposed remedy and this should be acknowledged by the CC. Indeed, this has been one point of contention in on-going discussions with operators

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<sup>11</sup> Which can often represent another 10-15% of total revenue in PTE areas

<sup>12</sup> Which we estimate to represent around 25% of total revenue based on figures quoted by the CC (p. C5 of the provisional decision on remedies)

<sup>13</sup> See Bonsall et al. (2007)

regarding Quality Contracts proposals. Understandably, commercial operators have been extremely reluctant to agree to any simplification of fare structures alongside the expansion of multi-operator tickets. We have concluded that this could only be achieved effectively in a more regulated context.

### Implementation and operating costs

7.12. The CC has based its estimate of the implementation and on-going costs of its proposed ticketing remedy (£2.6m) on the two following assumptions:

- Yearly on-going administration costs of £2,600 and a marketing budget of £80,000 (based on figures supplied by Nottingham City Council)
- The proposed remedy would not increase the level of on-going costs of existing schemes.

7.13. We would argue that these assumptions are likely to represent a gross under-estimate of the true costs of the remedy for the following reasons:

- Administration and marketing costs are likely to increase with scheme complexity (in terms of revenue allocation, variety of tickets available and governance arrangements). That is one explanation for the wide disparity in scheme administration costs quoted in table 1 (Appendix J, p. J4). This argument has been supported by discussions with a range of LTAs, in particular Nottingham CC, [redacted].
- There are likely to be substantial disparities in the way scheme costs are accounted for. For example, data collection costs may be accounted for as a fixed cost even though the main purpose of data collection could be revenue allocation. We would argue that a bottom up estimate of the resources required is necessary to come up with a meaningful cost estimate.
- The CC's estimate seems to ignore the management costs incurred by operators, which would be proportional to the number of operators involved in the scheme. Discussions with NCC also suggest that the figures provided to the CC exclude most of the staff costs incurred in both negotiating, developing, implementing and running the scheme.
- Even though the data obtained by the CC shows a wide variation in scheme administration costs between different areas it has chosen to adopt a figure at one end of the range without trying to understand the source of variations or including a sensitivity test in its cost estimates. We would argue that as scheme complexity increases operating costs are likely to approach those observed in PTEs. For example, NCC have told us that as part of on-going plans to develop its scheme, which are also expected to result in an increase in take-up, admin costs will [redacted] from £[redacted] to £[redacted] per year. This would result in a substantial increase in the CC's cost estimate.
- The assumption that on-going costs as a result of the proposed remedy will not change seems to us to be completely counter-intuitive based on our experience of developing ticketing schemes since the 1970s.
- We expect that the monitoring and enforcement of equitable marketing of single and multi-operator products could represent a significant additional cost to LTAs. Although we have not attempted a bottom-up estimate of this figure, it may be possible to express this as a proportion of current data collection costs. Another

important issue to bear in mind is that if the proportion of operator revenue were to come through a more sophisticated revenue settlement process, we would expect operators to spend a greater amount of effort and resources monitoring and managing the process. While we expect some of this cost could also be present in franchising under a net cost contract scenario it would be entirely absent from a gross cost contract scenario.

- 7.14. We would therefore expect an upper bound for the cost of this remedy to be substantially higher and suggest that this is taken into account in the CC's relative assessment of alternative remedies.

### **Impact on operational performance**

- 7.15. We have a concern that an increase in more complex on-bus transactions<sup>14</sup> could affect bus journey times and reliability. Our own analysis suggests that if all bus passengers were to switch to pre-paid tickets bus operating costs could fall by 3% and demand would increase by 3.8%<sup>15</sup>. We would expect a move from off-board to on-board ticket purchase to have the opposite (albeit much smaller) effect.

### **Implementation challenges**

- 7.16. With respect to the proposed voting mechanisms, we would argue that there could still be significant scope for voting to remain dominated by a small cartel of larger operators interested in opposing specific changes recommended by the CC. We anticipate this to become a particular issue in terms of the introduction of a new formula to set the price of MTCs. We would wish to ensure that LTAs would be able to push through changes even if opposed by a cartel of incumbent operators.
- 7.17. At the same time, there is a risk (albeit smaller) that a cartel of smaller operators predominantly active in the tendered market could attempt to influence the price of MTCs in a way that might be financially unsustainable.
- 7.18. With respect to the issues of pricing and revenue allocation, we would wish to point out that LTAs currently have only limited powers to obtain up to date fare structure and revenue information from operators, which is critical for both revenue allocation and pricing. The CC may therefore wish to make recommendations to relevant bodies to ensure the effectiveness of the proposed remedy.
- 7.19. With respect to the pricing formula proposed, it is important to point out that single tickets have declined substantially in terms of market share in some PTE areas and may in the future not be an appropriate basis for calculating the price of MTCs. This could create distortions and perverse incentives in the future. One possible way to overcome this issue would be to use a set of short period ticket prices (possibly including returns and day tickets) rather than single tickets alone as the basis for the calculation.

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<sup>14</sup> For example, the sale of a monthly multi-operator photocard compared to a simple single ticket which is automatically issued by a ticket machine.

<sup>15</sup> PTEG (2010), BSOG Devolution – Funding More Effective and Sustainable Bus Networks, Internal Report.

7.20. Even if LTAs are successful in delivering integrated ticketing with pricing in line with CC principles – something we doubt will result from the proposed governance arrangements -- it is likely that operators will still seek to position their own multi-journey products at a price that will ensure low take up of the integrated tickets. Operators will still have the option of setting pricing in such a way as to drive the integrated offers to the margins of the market.

### Implementation of smart ticketing

7.21. We agree that the development of e-purse smartcard ticketing products has the potential to support the set of remedies proposed by the CC, as well as to deliver wider benefits to passengers and operators.

7.22. However, we note, as we did in our response to the provisional remedies, that there are at present only weak requirements on operators to join LTA-led ITSO compliant systems and most of the larger operators have been very reluctant to join open systems. There is therefore a clear danger that although smart ticketing may be introduced, there will be a proliferation of ticketing products, including separate operator e-purses. This complexity may not only reduce the benefits for passengers of smart ticketing but could also deter new entrants. It is clear from our perspective that an element of compulsion requiring operators to offer their products as part of multi-operator e-purse products will be critical to ensure the effectiveness of this remedy.

## 8. Partnership remedy

**We do not accept that the primary benefit and objective of partnerships is to promote greater on-street competition. The experience of partnership working hitherto does not support this, and we can see no reason why the relatively modest measures proposed by the CC will make a material change.**

**On the other hand, the partnership provisions in the LTA 2008 are now beginning to bring real benefits to passengers. We feel that the approach the CC takes in its report threatens to turn the clock back by raising the same vague doubts over the value of any scheme that excludes the theoretical possibility of low end competition and which inhibited partnership working in the past.**

### Partnerships and the promotion of on-street competition

8.1. There appears to have been a subtle, yet potentially radical, shift in the CC's position as regards partnerships. Whereas the provisional remedies recognised that, seen as a regulatory tool, partnerships can have the potential to maintain a stable competitive equilibrium where competition has previously developed, the latest report now seems to suggest that partnerships can help directly encourage competition through new entry<sup>16</sup>.

8.2. In our view, the achievement of a stable competitive equilibrium through partnerships is incompatible with the explicit objective to see an increase in on-street competition through new entry. We therefore do not believe that the proposed remedy can address the AEC in the way suggested by the CC in its latest report. Moreover, the legislative

<sup>16</sup> Paragraph 259: "We concluded that partnerships that had the effect of growing bus patronage could indirectly address the barriers to entry

framework governing partnerships is already in place so we cannot see how any of the CC's proposals would constitute an additional remedy.

- 8.3. However, we continue to strongly believe that binding partnerships can indeed work as a regulatory tool to address the detrimental effect of the AEC on consumers and would encourage the CC to consider how the existing legislative framework could be strengthened further to increase their effectiveness. We also feel that where partnerships have been made to work they can deliver a range of additional benefits and would urge the CC to refrain from undermining the existing regulatory framework in any way.

### Could partnerships promote new entry?

- 8.4. The CC argues that partnerships could stimulate new entry by:
- improving information provision to passengers
  - contributing to patronage growth.
  - stimulating market growth, which would in turn attract new operators.
- 8.5. With respect to information provision, we understand this to apply to timetable information<sup>17</sup>. We agree that knowledge of timetables and running times can be an important factor in promoting a stable competitive equilibrium where competition exists<sup>18</sup>. We also agree that a new entrant would find it profitable to run new services immediately ahead of existing scheduled services. However, we do not believe this type of hit and run entry could lead to a stable competitive equilibrium, as demonstrated by Evans (1987).
- 8.6. We do recognise that partnerships can be an effective way to achieve a commitment from operators towards information provision. In some PTE areas, the use of partnerships has been critical in developing high quality passenger information systems. However, we would also note that most PTEs, often in partnership with operators, already provide extensive amounts of public transport information to passengers. For example information in many PTE areas is now available **in operator-neutral format** via: printed timetables; at bus stops displays; internet travel planner services; mobile phone applications; real time display at bus stops and stations; and real time text services. It's therefore difficult to understand why the CC believes the gap in information is so significant that filling that gap will attract new entrants to the market. We therefore do not anticipate that this further example of CC wishful thinking would have a material impact in this regard.
- 8.7. With respect to market growth, the notion that this would attract new entrants does seem intuitively appealing, as an increase in passengers could mean that in due course it would become profitable to employ an additional bus on the route. However, it's important to note that this would also create a strong incentive for the incumbent operator to protect its own market. The problem is that there are significant asymmetries of information between the incumbent and any potential new entrant:
- the incumbent will be far better positioned to detect changes in demand

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<sup>17</sup> Although the Transport Act 2000 uses a much broader definition, which includes fares information.

<sup>18</sup> Labelled by Ellis and Silva, 1998 as '*coordinated demand effects*'

- the incumbent will be far better positioned to identify the point at which running an additional service would become profitable, whereas a new entrant would have to take a significant gamble.
- 8.8. Although the CC does acknowledge the issue of asymmetry of information in the context of franchising (where we believe it is a much lesser problem, at least in large urban areas<sup>19</sup>) it seems to overlook this altogether in the context of competition between incumbent operators and potential new entrants.
- 8.9. We would also wish to point out that we are not aware of any evidence of new entry directly as a result of the introduction of any form of partnership. The CC quotes evidence submitted by Nottingham City Council that could be seen to contradict this points. We have therefore sought further information from NCC who told us that new entry had indeed occurred in some parts of the city (though it only occasionally remained) but that it did not see this as being the direct result of specific partnership measures<sup>20</sup>.
- 8.10. Overall, we cannot see how partnerships could act as a market opening tool in the way intended by the CC.

#### **How can partnerships improve the functioning of bus markets?**

- 8.11. Although we do not believe that partnerships can act directly as a remedy to the AEC, we feel that the CC's mixed messages about the potential role of partnerships could risk undermining what has gradually become a sound regulatory framework and a valuable working tool in some parts of the country. We therefore feel it's important to re-state our views on the contribution that partnerships can make to the improved functioning of local bus markets as we're not sure these have been properly understood.
- 8.12. Where a corridor is dominated by a single operator, a quality partnership can often be used to negotiate a commitment towards a higher quality service and, in some cases, to prevent excessive fare increases. Where two or more operators run services in parallel, partnership agreements can help mitigate the negative effects of unstable on-street competition, for example by constraining the number of services on congested corridors, regulating city centre stop access, preventing frequent service changes (with a negative effect on passengers) attempting to maintain regular headways and stable timetables, promoting a higher quality of service or preventing excessive and frequent fare increases.
- 8.13. In the case of headway/timetable regulation and higher quality it's highly unlikely that the outcomes delivered by partnerships could be achieved in tandem with the pursuit

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<sup>19</sup> Most PTEs carry out a large rolling programme of on-board passenger surveys for the purpose of concessionary reimbursement, which allows them to estimate travel patterns and revenue by ticket type with some degree of accuracy. These surveys can be used to estimate, for example, trip length and mean vehicle occupancy two variables which are often not readily available even to incumbent operators as they typically rely on Electronic Ticket Machine data which only records boarding point with any degree of accuracy.

<sup>20</sup> We believe it's also important to point out that there are a number of reasons why new entry would be more likely in the Greater Nottingham market, not least the fact that the two largest operators (NCC and Trent Barton) are effectively medium sized operators (with around 350 buses each) with no ability for cross-subsidy between different markets as they're not part of a larger operating group.

of low quality entry. With respect to the issue of timetable regulation, in particular, different authors<sup>21</sup> have shown that this is a crucial factor without which a stable competitive equilibrium is unlikely to exist. In that sense, partnerships can also contribute to competition.

- 8.14. One obvious reason for this is that unregulated new entrants could easily erode the profit margins of existing operators, for example, by running additional services just ahead of scheduled times. This would trigger a rational response by the incumbent which would undermine the agreed timetable and wipe out profits on the route until only one operator was left in the market (see Evans, 1987 for an illustration of this process).
- 8.15. This is the type of behaviour that was frequently observed in the period post-deregulation<sup>22</sup>. White (1997) argues, with respect to this period, that *“a much greater benefit would have been produced in the metropolitan areas if instability effects had been avoided, and if additional unproductive service kilometres had not been operated. A much better financial performance would also have resulted, with not only lower total operating costs, but also higher revenue”*.

### ***The overriding objective of partnerships***

- 8.16. At a fundamental level, we do not accept that the primary benefit and objective of partnerships is that they have the theoretical possibility of resulting in more on-street competition. From our perspective, partnerships are about operators and LTAs working together with the objective to achieve long term growth in the bus market, by delivering the best product for bus users in the most cost-effective way. The experience of partnership working hitherto does not suggest that it results in greater competition, and we can see no reason why the relatively modest measures proposed in the report will ensure that in future partnerships will result in more on-street competition.
- 8.17. However, where they have been shown to work, partnerships can have a number of additional positive effects on the local bus market, including:
- Potential market growth and reduced costs can persuade operators of the benefits of integrated ticketing and a jointly planned network, at least in the short term (i.e., at least, until becoming more exposed to effective competition);
  - Partnerships can have a moderating effect on operator conduct as they are based on a sense of trust and commitment between stakeholders;
  - Partnerships can help align public and private sector objectives to some extent by allowing LTAs to get involved in service specification and the development of integrated ticketing;
  - Partnerships can help align public and private sector investment, hence achieving synergies;
  - Partnerships can lead to more open and effective sharing of information between operators and LTAs, as is the case, for example, with respect to the use of vehicle

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<sup>21</sup> Evans (1987) and Ellis and Silva (1998)

<sup>22</sup> There were between 850 and 2000 changes to services in each metropolitan area during 1988 (Tyson, 1990).

tracking data, which has been used in some areas to target investment at particular congestion hotspots.

### ***Changes to the regulatory framework***

- 8.18. We would therefore urge the CC to refrain from undermining the existing regulatory framework. Following on from the Local Transport Act 2008 significant progress has been made in implementing high end voluntary partnerships, Statutory Quality Partnerships and Qualifying Agreements. These are bringing real benefits for passengers right now. The approach the CC takes in its report risks turning the clock back by raising the same vague but threatening doubts over the value of any scheme that excludes the theoretical possibility of low end competition. This is the approach that inhibited partnership working prior to the Local Transport Act 2008, and was unsuccessful in its own terms, in that it did not succeed in achieving greater on-street competition that the CC is seeking.
- 8.19. At the same time, we welcome the CC's recognition that LTAs are an important stakeholder in a partnership context, and can help prevent the risk of an increase in the AEC as a result of collusion between operators. We therefore agree that LTAs should remain a party to all agreements (including Qualifying Agreements), as is currently the case.
- 8.20. Building on the previous point, we would argue that there is a need for greater visibility of operator data by LTAs in the context of partnership agreements. As a minimum, we feel that operators should be required to supply any data to LTAs that would allow them to understand the level of success from partnership working in any given area. This could also help LTAs better target their investment. In addition, this type of information could help ensure operators understand the value of partnership working when considering whether to take part in a voluntary agreement.
- 8.21. Going one step further, we would argue that greater visibility of cost and revenue data would also address another important obstacle to effective partnership working, which is [redacted]. Unless there is greater transparency in this respect, it is difficult for an LTA to judge either the likely effect on competition of a partnership arrangement, or to [redacted]. Access to better information would enable LTAs to deliver better value for public money.

## **9. Tendered market**

### **Information remedy**

- 9.1. The PTEs welcome the CC's recommendation regarding the introduction of legislative changes giving LTAs powers to obtain monthly patronage and revenue data from operators for the 12 months prior to service deregistration.
- 9.2. Given the potentially limited opportunities for new legislation in the current parliament we also support the CC's suggestion that LTAs seek to enter into voluntary information sharing agreements with operators. In our experience, some operators have been forthcoming with respect to data sharing, albeit subject to confidentiality agreements which would preclude data being released to competitors as proposed by the CC. We would point out, however, that this part of the remedy should take the form of a recommendation to operators (who own the data) and DfT (who may be able to issue

relevant guidance, for example, in relation to BSOG and concessionary travel reimbursement) rather than to LTAs.

- 9.3. In addition, we would encourage the CC to consider extending this proposal to encompass the transition to a franchise regime as this could reduce some of the risks identified by the PTEs and in the provisional decision on remedies. This could involve the requirement that the same information be made available to LTAs, for example, 12 months ahead of the transition to a franchised arrangement.

### Tendering guidance and best practice

- 9.4. The PTEs support the CC's general recommendation for the DfT to update existing guidance on the procurement of tendered services. We comment below on specific proposals that the CC suggests could be taken into account in new guidance.
- 9.5. **Contemporaneous award of all tender contracts.** Although we do not consider lack of potential new entrants into the tendered market to be a significant problem in PTE areas, we can see how the simultaneous tendering of large parts of a network could potentially lead to economies of scale (for example, relating to depot size) and to the realization of operational efficiencies. Effectively, this is one of the procurement options some PTEs have explored as part of their soft market testing relating to the introduction of Quality Contracts. The PTEs clearly recognise that it is important to incentivise bidders and potential bidders in the way that will deliver the most efficient outcome.
- 9.6. However, we would also note that whereas larger tender contracts may lead to better outcomes in some circumstances they could also contribute towards excluding smaller, yet efficient, operators from bidding.
- 9.7. **LTA ownership of depots.** We agree that LTA depot ownership (and equally the ownership of vehicle fleets) could reduce the barriers to entry into the tendered market. We also note that this type of approach would be just as effective in reducing barriers to entry into a franchised market. However, the extent to which a given LTA would wish to implement this approach at a given point in time will depend on the balance between benefits and risks.
- 9.8. **Scope for greater flexibility in contract length, risk allocation, assessment of non-compliant bids and the specification of services by bidders.** We note that greater procurement flexibility was an idea supported by some (though not all) operators and we would agree that there could be advantages in making as much use of operators' commercial and operating expertise as possible as part of bidding processes. We also note that a more flexible approach would be equally applicable in the context of franchising of commercial networks.

## 10. Operator behaviour remedy

### Extension of notification periods

- 10.1. The PTEs welcome the recommendation to introduce a 14-day pre-notification period to LTAs ahead of formal service registrations. We feel that this will enable PTEs to improve the level of service provided to customers and will also support the planning of tendered networks.

10.2. With respect to the proposal to extend the registration notice period for service changes from 56 to 90 days, while we agree with the spirit of the remedy we do not feel that, as set out, it will have any material impact on operator behaviour. The reason is that operators will still be able to use the 56-day notice period so as long as new services differ in some way from existing ones. Given that any variation from an existing service would represent a new service this remedy would be completely ineffective in practice.

### **Predatory pricing and regulatory accounting**

10.3. One remedy that we were surprised not to see in the CC's provisional decision is the regulation of predatory pricing. Effectively, the only current constraint on this type of behaviour in response to new entry is for the matter to be taken to the OFT by the new entrant. However, this in itself does little to diminish the resulting barrier to entry, as we've argued in our response to the provisional remedies. Given the disparity in size and financial clout between the largest incumbent groups and potential new entrants we expect the possibility of predatory pricing to represent a highly effective deterrent against new entry even if it may only rarely be observed in practice.

10.4. We therefore believe the potential of regulatory accounting has not been fully recognised by the CC. The CC acknowledges the key role for LTAs in helping to identify and address market failure but provides us with few tools with which to clearly determine where this may be taking place. We believe that if some form of regulatory accounting was to be introduced this would discourage predatory pricing and hence reduce barriers to entry.

### **Voluntary Code of Conduct**

10.5. The PTEs welcome the CC's proposal to introduce the concept of a voluntary code of conduct and, indeed, some PTE areas already have this type of tool in place, often in the context of voluntary partnerships.

10.6. However, we would question the ability of the Traffic Commissioners, given their current remit and limited resources, to monitor adherence to the code of conduct or to take into account the different issues that are of most relevance in each area.

10.7. Based on the points above, it is our overall assessment that the proposed set of remedies will have no material effect on the bus market in PTE areas.

## 11. BSOG

**BSOG could potentially be used to incentivise positive outcomes on areas such as ticketing. However there is a considerable amount of work to do before it becomes clear whether such incentives would be effective, and how they would be administered and validated on a national scale in pursuit of finely calibrated and uniquely local circumstance. There are also potential legal hurdles in relation to EU Competition Law which the CC appears unaware of. Overall, it is our view that in PTE areas BSOG would be better utilised through devolving it in a ringfenced way so that PTEs could target it effectively in line with local circumstances and objectives which could include incentivising positive outcomes on ticketing and information.**

11.1. The CC suggests that the DfT may wish to consider how to use BSOG to incentivise:

- the development of, and participation in, multi-operator ticketing schemes
- compliance with a voluntary code of conduct
- investment, through partnerships, in particular relating to information provision.

11.2. Given how long it could take to introduce and fully implement the primary legislation needed for the CC's ticketing remedies, the implication is that the use of BSOG funding is presented as a further and potentially more rapid way in which the CC's package of recommendations could be incentivised. However, the report provides very little evidence of thinking of how this could be practically achieved.

11.3. The challenges include:

- How do you validate, and on the basis of what criteria, payment of taxpayer funding for 'compliance with a voluntary code of conduct'. Would there be a national minimum baseline for such codes of conduct? Who would determine whether or not an operator had complied with the code of conduct? What would happen if an operator was judged to have complied with nine out of ten of the bullet points in the code of conduct? Who would adjudicate when there was dispute between the parties of the code of conduct of whether or not the code of conduct had been met in full?
- Similar questions arise over the second two suggested uses of BSOG. For example. How do you define a tipping point where an operator qualifies for BSOG because there is 'investment through partnerships in relation to information provision'?
- How do you strike a balance between the three different objectives that the CC outlines in a payment system without it becoming unwieldy to administrate and validate?
- What proportion of the BSOG subsidies would have to be devoted to each of the three objectives to have a meaningful impact on operator behaviour? What would be the consequences for the different bus markets (for example rural and urban) of significant changes to the way BSOG is paid?
- It is worth noting that in previous discussions with the DfT on reforms to BSOG a prime consideration for the DfT has always been simplicity of administration as the current administrative costs of the system are very lean.
- It is also worth noting that there are significant state aid considerations around BSOG that make changes to the way in which it is paid potentially problematic. For

example EU law implies that future BSOG payments will need to be made on a contractual basis (through a Public Service Obligation) that ensures that there is no distortion of competition. It's ironic that the Competition Commission seems unaware of this issue, or at least makes no mention of this potentially significant hurdle to its aspirations for BSOG in the report.

- 11.4. **pteg** has argued that where BSOG can be ringfenced for bus networks it should be devolved, as a flat national payment criteria inevitably leads to unintended consequences and inefficiencies. For example the payment of BSOG incentive payments for smartcard readers where local transport authorities have already paid operators for readers to be fitted. PTEs are well placed to target BSOG support in a way that best meets local circumstances, objectives and opportunities. This could include better information systems and facilitating multi-operator ticketing systems. However if in a particular locality these arrangements were already satisfactory and in place then it would be a waste of public resource to provide windfall payments to operators for doing something that they were already doing. Other priorities may bring greater rewards such as bus priority measures.

## 12. Effective competition enforcement

12.1. We welcome the CC's recommendations that:

- the OFT should continue to apply a high priority to identifying bus mergers between competing operators.
- the OFT should routinely follow up bus mergers where it expects to have jurisdiction
- the OFT to revise its FAQs about the application of competition law to the bus industry.

12.2. However, we do not feel that these recommendations will materially change the role of the OFT or the way in which it has conducted its business in the past.

12.3. We should also point out that this remedy will have no effect in reducing the degree of concentration currently observed in the local bus market.

12.4. Our overall assessment is therefore that this remedy will make little or no contribution towards reducing the existing AEC.

## 13. Equitable and fair access to bus stations

13.1. Although we support the principles set out by the CC which underpin this remedy, we do not consider this to contribute to addressing the AEC in PTE areas given that we have very few examples of operator owned stations.

## 14. Overall assessment of the effectiveness and cost of proposed remedies

14.1. The Enterprise Act 2002 states that, having identified a significant Adverse Effect on Competition (AEC) the CC shall, in considering what actions should be taken, have regard to the need to "*achieve as **comprehensive** a solution as is **reasonable** and **practicable** to the AEC and **any detrimental effects on consumers***"<sup>23</sup>.

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<sup>23</sup> Enterprise Act 2002

14.2. We argue in this section that the CC's recommendations are neither comprehensive nor as practicable as some of the available alternatives.

### **Adverse Effect on Competition (AEC)**

14.3. The CC identified an AEC due to the presence of the following characteristics in local bus markets:

- Concentration (paragraph 16);
- Barriers to entry and expansion (paragraph 17);
- Customer conduct (paragraph 18).

14.4. Below we discuss whether the proposed remedies are likely to comprehensively address these characteristics of local bus markets.

### **Concentration**

14.5. The CC's route and urban area analysis states that *"in the vast majority of urban areas, there are very few routes that we can identify as unlikely to face an AEC"*.

Fundamentally:

- 38% of all areas are classified by the CC as 'near monopoly' (paragraph 52 b);
- 36% of all areas are classified by the CC as 'near duopoly' (paragraph 52 c).

14.6. We would highlight that in many parts of PTE areas the proportion of routes that are considered to be 'near monopolies' is significantly higher than this.

14.7. Despite the extent of this problem, we consider that the CC has proposed no remedy with the potential to reduce the current degree of concentration in the local bus market. Given that the detriment to consumers will tend to be greatest where incumbent operators have the greatest degree of market power, we cannot agree that the CC's proposed remedies represent a comprehensive solution to the problem.

### **Barriers to entry**

14.8. The CC has identified the following potential barriers to entry or exit in local bus markets:

- Incumbents' advantages arising from network strength
- Incumbents advantages arising from an ability to offer more attractive multi-journey tickets than smaller operators, particularly where there is no effective MTC available
- Costs or ease of access to bus stations
- Cheap exclusion by incumbents
- Expected intensity of post-entry competition
- Sunk cost of entry
- Ability to find suitable depots

14.9. We believe that the CC's proposed remedies have the potential to address the first four points. However, we would argue they only partially address the fifth and sixth points and do not deal with the final point at all.

- 14.10. With respect to the intensity of post-entry competition, the CC's remedies do not deal with the issue of predatory pricing, which, as we argue above, will weaken the effectiveness of the proposed operator behaviour remedy.
- 14.11. In addition, we believe that there are further barriers to entry which the CC has failed to identify. These barriers are discussed below.
- 14.12. **Economies of scale at route level.** We wish to question the conclusion in the provisional findings quoted in paragraph 70 of the route and urban area analysis:  
*“In paragraph 8.38 to 8.40 of the provisional findings we conclude that there is no evidence to indicate that economies of scale generally exist at the route level to the extent that they would affect the sustainability of head to head competition along a route. In general, therefore, we would expect to see head to head competition but for the features outlined in the paragraph 68.”*
- 14.13. Work by Evans (1987), based on spatial competition models and taking into account the fact that the number of buses operating on a route can only be increased in discrete steps, demonstrated that there are indeed economies of scale over certain demand intervals. Based on this result, the author suggests that bus routes are ‘partial monopolies’.
- 14.14. **Asymmetries of information.** The CC has identified asymmetries of information regarding patronage and revenues between incumbent operators and LTAs as a significant risk in the introduction of Quality Contracts. However, it has failed to recognise the much greater<sup>24</sup> asymmetry of information that exists between incumbent operators and potential new entrants. Allied to the point that new entry may only be profitable<sup>25</sup> over certain demand intervals, this means that the incumbent will always be better positioned to identify the point at which an increase in supply might become profitable.
- 14.15. Our overall assessment is that the CC's proposed remedies will only partially address the barriers to entry that are a feature of local bus markets.

### **Consumer conduct**

- 14.16. The CC has identified passengers' relative valuation of fare and travel time as a barrier to competition. We believe that the proposed ticketing remedy goes a considerable way towards addressing this issue. However, we have significant concerns that the CC's express wish to introduce a greater degree of unregulated on-street competition could eliminate the potential consumer benefits of multi-operator

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<sup>24</sup> Most PTEs carry out a large rolling programme of on-board passenger surveys for the purpose of concessionary reimbursement, which allows them to understand travel patterns and calculate revenue by ticket type with some degree of accuracy. These surveys can also be used to estimate, for example, trip length and mean vehicle occupancy two variables which are often not readily available even to incumbent operators as they typically rely on Electronic Ticket Machine data which only records boarding point with any degree of accuracy.

<sup>25</sup> Evans (1987) points out that, even within these demand intervals, new services inserted equidistantly from existing timetabled departures by a new operator are unlikely to be profitable in the short term, and would only become profitable once the incumbent operator adjusted its own timetable accordingly to accommodate the new service. This assumes the two operators would coordinate their timetables, which seems unlikely to happen in a deregulated competitive environment.

tickets by stimulating the type of unstable competition which prevailed in the post-deregulation period.

### **Expected impact of the proposed remedies**

14.17. Paragraph 507 of the provisional decision on remedies states that:

*“It is not possible to quantify with precision the customer benefit associated with increased competition. We have not been able to quantify every aspect of the detriment resulting from the AEC, nor are we able to quantify with precision how much of this detriment would be removed by our package of remedies.”*

14.18. We have expressed significant doubts about whether the proposed set of remedies does indeed comprehensively address the AEC. Moreover, we do not believe the CC has provided any evidence to support its statement that this package of remedies will be more effective at addressing the AEC and resulting consumer detriment than the alternative remedies. Therefore, we would call on the CC to re-consider its views on alternatives and, in our view, much more comprehensive and effective remedies, as is the case of franchising.

### **Implementation timescales**

14.19. In paragraph 488 of the provisional decision on remedies the CC states that:

- *“(...) we would expect our remedies to have been fully implemented and to result in substantial impact on the AEC and the resultant consumer detriment **within three to five years of publication of our final report.**”*
- *“(...) we are not aware of any other effective and proportionate remedies that would deliver results in a shorter timescale than this.”*

14.20. We have serious doubts that the CC’s remedies could have a material effect any sooner than five years from the publication of the final report. There are two reasons for this:

- Firstly, we do not believe that the key remedies could be effectively implemented without primary legislation (see annex one). The CC suggests that the current regulatory framework allows some of these measures to be implemented by LTAs in partnership with operators<sup>26</sup>. However, this simply ignores the fact that, in a highly concentrated market, incumbents have very few incentives to facilitate the introduction of measures which would ultimately reduce their market power.
- Secondly, the CC seems to assume that once legislation is in place it will be straightforward for LTAs to introduce its array of measures. In our experience, the implementation of any changes in the context of the deregulated bus market has proven a lengthy and testing process, as is illustrated by the development of multi-operator ticketing schemes and quality partnerships. For example, it took over two and a half years from the enactment of the LTA 2008 for the first Qualifying Agreement covering frequencies and integrated ticketing to be signed.

14.21. In contrast, we believe that both franchising and increased regulation through statutory partnerships and qualifying agreements could be introduced within much

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<sup>26</sup> Paragraph 485 of the provisional decision on remedies

shorter timescales given that the necessary legislative framework is already in place and in the case of the latter two measures a growing consensus around their use and benefits.

## 15. Franchising remedy

**The CC systematically overestimates the costs and risks it associates with franchising, often disregarding evidence already submitted by PTEs. Yet, at the same time, the CC offers no proposals on how those risks and costs could be reduced through regulatory or other means. Whilst accepting its own narrow remit the CC goes onto make the unsubstantiated claim that its proposed remedy package is superior to a proven method for the provision of high quality and integrated public transport and for the introduction of competition for markets that are currently locked up by lightly regulated ‘near monopolies’ and ‘near duopolies’. [✂].**

- 15.1. The PTEs are of the view that the introduction of some form of franchising could effectively inject greater competitive forces into the market. Indeed, this was recognised in the 2000 Transport Act, whose provisions in respect of Quality Contracts were later reinforced in the 2008 Local Transport Act. We therefore welcome the CC’s acknowledgement<sup>27</sup> that there is a clear legal basis for utilising franchising and that LTAs, in considering this option, need to take into account wider objectives brought about by its statutory duty to “*secure the provision of such public passengers transport services as the Authority for the area consider appropriate*”<sup>28</sup>.
- 15.2. However, the PTEs are disappointed by the change of view expressed in the CC’s provisional decision on remedies about franchising, and would question the basis upon which it has come to this conclusion. We are unclear why the CC has stated that “*we do not consider that area wide franchising could address the AEC directly*”<sup>29</sup>. Whether the remedy addresses the AEC directly or indirectly seems a moot point provided the remedy can deal with the AEC. The ability for franchising to address the AEC indirectly is present throughout your work<sup>30</sup> (and factually correct, in our view) and should be expressly acknowledged.
- 15.3. We note that two small operators (McGills and Huytons, paragraph 13, Appendix I) and two larger operators (Rotala and Go-Ahead, paragraph 12, Appendix I) have acknowledged the potential merits of a franchising solution. We would also highlight that, despite the statement by Stagecoach in paragraph 14, Appendix I, all large UK bus operators are actively involved in the competitive tendering of public transport services in the UK or abroad.

<sup>27</sup> Paragraph 435

<sup>28</sup> Section 9A, Transport Act 1985

<sup>29</sup> Paragraph 404

<sup>30</sup> Paragraph 36, Appendix I: “*We would expect to see some competition for area-wide franchises*”.

Paragraph 49, appendix I: “(...) at the point of tender, barriers may be lower than under a deregulated model as an efficient operator does not have to contend with post-entry competition, network strength, cheap exclusion and **unstable competition**.”. Paragraph 73, Appendix I: “(...) franchising is in principle a practical alternative to competition in the market and could be made to operate successfully”.

- 15.4. We also strongly contest the assertion that: *“our proposed remedy package directly addresses the AEC, is at least as effective in addressing the associated customer detriment and is less costly and therefore provides a more proportionate solution to the AEC than franchising”*<sup>31</sup>.
- 15.5. In particular we would highlight the CC’s own view that *“it is not possible to quantify with precision the customer benefit associated with increased competition. We have not been able to quantify every aspect of the detriment resulting from the AEC, nor are we able to quantify with precision how much of this detriment would be removed by our package of remedies.”*<sup>32</sup> This is in stark contrast with franchising where at least one PTE has produced a complete business case illustrating the costs and benefits of the introduction of a Quality Contract. Other PTEs have also undertaken, or are in the process of commissioning, additional work in this area. Moreover, there is a substantial empirical and theoretical evidence base which suggests that the competitive award of exclusive operating rights can achieve the same level of x-efficiency as outright deregulation, while eliminating excess profit and improving dynamic efficiency<sup>33</sup>.
- 15.6. We have contended in our response that the CC has overstated the impact of its proposed remedy package, while understating its costs and implementation timescales. On the other hand, we argue below that the CC has overestimated the costs and risks of franchising but not taken into account the efficiencies that will offset such costs as well as the wider consumer benefits that could result.
- 15.7. We believe that franchising has the potential to significantly exceed the proposed remedy package. We also believe franchising can be a more effective means of increasing competition. We recognise that this is competition for the market rather than in the market, but set out below our reasons for believing that this form of competition has benefits as well as shortcomings over traditional on-the-road competition:
- Franchising has great potential to simplify and provide far greater ‘legibility’ of local bus services, making it more attractive to passengers and growing the bus market.
  - The full use of the available non-franchising remedies could effectively close down the local market and make new entry more difficult. The CC proposes no remedies to address the current level of concentration. Thus the periodic opening up of the market through franchising is a more effective use of competition to encourage efficient suppliers.

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<sup>31</sup> Paragraph 8

<sup>32</sup> Paragraph 507

<sup>33</sup> Please see the reference list in PTEG’s response to the provisional findings and remedies. In particular, we would highlight the work of Evans (1987) and White (1990) which show, respectively that:

- A profit maximising regime (i.e., the current deregulated market) leads to higher frequencies, higher fares and lower consumer surplus than a welfare maximising regime (which would be closer to that which LTAs would attempt to achieve under franchising).
- There was a substantial reduction in operating costs following privatization both in London and in deregulated parts of the country. In interpreting the figures, it should be noted that privatization and competitive tendering in London didn’t progress at the same rate as privatization in other parts of the country.

- Franchising offers the opportunity to use proceeds from one part of the network to subsidise welfare maximising services elsewhere in the network<sup>34</sup>. Operators can, and we suspect indeed do, cross-subsidise their operations between different areas, and we would argue this is not always in favour of the passenger.
- Even where franchising may not be cost-effective, the realistic option of franchising is a powerful negotiating tool in negotiations between LTAs and operators.

### **Additional benefits from franchising**

- 15.8. LTAs have a strong incentive to increase the mode share of public transport modes, particularly where car use can be reduced. This can create economic and environmental benefits that strengthen the competitive case for franchising. The CC's analysis is understandably limited in these areas, since its remit concentrates on increasing competition rather than to do so in a way that furthers the public good.
- 15.9. We welcome the conclusion that there are potentially net benefits to be released from greater innovation that may be possible through franchising. PTEs have been at the forefront of innovation in several areas of bus service development, notably real-time information, smartcards and improved passenger facilities. In some cases such innovation has been resisted by operators. It is clear, for example, that franchising would facilitate much quicker progress with smart ticketing than has been the case in the deregulated market. We therefore cannot agree with the arguments of large operators, set out in paragraph 10 of Appendix I.
- 15.10. We believe opportunities for innovation will also include co-ordination with other modes and with other bus services, marketing, branding and more responsive/directed services. The CC should recognise that franchising will allow these further innovations which will benefit both bus users and consumers in other markets. It is notable that the UK bus director of one of the major operating groups has recently highlighted the efficiency benefits that could be obtained by combining different elements of public transport<sup>35</sup>. This is something that LTAs are better placed to deliver through a franchised approach.

### ***Simplicity and legibility***

- 15.11. Franchising introduces the possibility of simplification of services and fares which may be in the interests of passengers, but is not an outcome that the market generally produces. The development of straightforward fare systems and legible networks is a key element of TfL's success in encouraging bus patronage. A review of a number of international examples where simplified ticketing was introduced has shown that this can contribute to significant patronage growth (Booz, 2009). This is also supported by recent work for the Department for Transport (Aecom, 2009), which suggests that

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<sup>34</sup> Evans (1987) shows that a proportion of non-commercial services should be operated on welfare maximising grounds. He also demonstrates that it may maximise welfare to divert resources which profit maximising operators would use to increase frequency on core sections of the network to lower demand areas.

<sup>35</sup> Mike Cooper, executive director of Arriva plc, quoted in Local Transport Today (LTT 562, 21 October 2011): 'You can get efficiencies out of each one, but with all three (special educational needs, social services and conventional buses) blended together you can get something quite special.'

passengers are willing to pay up to an additional 14p per trip for a simpler fares and 46p per trip for a fixed fare structure.

- 15.12. Competitive solutions often do not generally yield easily comprehensible and stable solutions. This is particularly the case with fare systems – as can be seen in unregulated rail fares. Much of the current concern about domestic energy pricing is related to the unnecessary complexity of the market offer.

### **Appropriate use of franchising**

#### **Significant market failure**

- 15.13. The appearance of the ambiguous phrase „significant market failure“ in relationship to Quality Contract appears in isolation and is not justified by argument or rationale in the supporting text or appendices, nor is it part of the process that Parliament approved for Quality Contracts. We argue that it should therefore be removed in the final report as the CC has presented no justification for its inclusion.
- 15.14. The current tests for the implementation of a QC are to determine whether it is in the public interest and whether the impacts on bus operators is proportionate to the improvement in wellbeing of the public/users and to the improvement in the services. One of the key public interest criteria that an LTA must make in demonstrating its case for franchising is that *‘the proposed scheme will result in an increase in the use of bus services’*<sup>36</sup>. We would argue that these criteria implicitly take into account the occurrence and extent of market failure.
- 15.15. We would request that the CC acknowledge that the use of franchising is appropriate where the LTA demonstrates that franchising is a proportionate way to deliver better bus services and improved outcomes for passengers.
- 15.16. We believe that the combination of the primary legislation and the statutory guidance are sufficiently clear and detailed to ensure that franchising is only used in appropriate circumstances, and that it is unnecessary for the Commission to seek to add further criteria to the process of introduction.

#### **Delivering competition in the most effective way**

- 15.17. In paragraph 404 the CC states that *“area wide franchising would restrict and sometimes remove competition from the relevant franchised area for a period”*. We acknowledge this as a fact, however it is clearly important to a franchising authority to ensure there is effective competition generally, whether ‘in’ or ‘for’ the market.
- 15.18. The franchising legislation allows for services to be excluded from a QC<sup>37</sup> scheme and for Clearance Certificates<sup>38</sup> to be granted for new services. These powers facilitate continued operation of commercial services within a QC area, for example, inter-city services.
- 15.19. In the design of any franchised system LTA’s would clearly have regard to the desirability of retaining or stimulating competition ‘in the market’ where that would be

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<sup>36</sup> Also to be understood as the reduction of the rate of decline previously observed.

<sup>37</sup> s127 (4) Transport Act 2000

<sup>38</sup> s6B (5) Transport Act 1985

most beneficial to passengers and to the longer term health of the market. Evidence from a number of European countries shows that different regulatory and competitive regimes can work effectively side by side within a given metropolitan area<sup>39</sup>. We therefore do not believe the issues raised by operators, and highlighted in paragraph 79(c), are relevant.

15.20. We would also agree with paragraph 52 of the CC notice of possible remedies, that there is scope for a QC to be a market opening measure. Indeed, this is what we believe the CC itself has argued with respect to the tendered market and what it hopes its own remedies relating to the tendered market are trying to achieve.

### Costs and risks

15.21. We consider that the CC has grossly over-stated the net costs, and associated risks, of a move towards a franchising model in individual PTE areas and has given little weight to evidence already presented by PTEs with no justification or explanation for doing so. While franchising may indeed give rise to additional costs to PTEs and operators it is not necessarily the case that this would result in a net cost for the market as a whole. In particular, we would argue the following points:

- PTEs would be able to absorb a substantial proportion of additional costs within their existing activities, for example data collection and non-commercial tendering.
- Some costs would represent a transfer from operators to PTEs. In that case, there may actually be savings due to economies of scale. The CC's analysis seems to ignore potential efficiency gains and economies of scale, for example, in network design, planning and specification.
- PTEs could rationalise the current tendering process which is highly fragmented given the need to separately tender a large number of small contracts, many of which represent either route extensions or single early/late departures.

15.22. The three PTEs actively considering the introduction of a QC scheme have provided their business case evidence to the CC, which suggests that the additional costs of operating a QC are likely to be under £1m per year<sup>40</sup>, and potentially much less under some assumptions. Although the CC has been given this evidence, worked out on a bottom-up basis and taking into account local operating factors and budget constraints, our figures seem to have received no more weight<sup>41</sup> than the aggregate estimate carried out by TAS for the DfT in 2003<sup>42</sup>, which puts the cost at £5m per year.

15.23. In relation to the London comparisons, the CC's assessment fails to recognise the following points:

- TfL operates a highly specified gross cost route franchising model, which significantly reduces the overhead costs to operators. Yet, these savings to operators are not acknowledged by TAS or the CC.
- TfL explained to the CC why its staff numbers may be high compared to other areas<sup>43</sup>.

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<sup>39</sup> Innov8 (2010)

<sup>40</sup> Paragraph 86, Appendix I of provisional decision on remedies.

<sup>41</sup> Paragraph 100, Appendix I

<sup>42</sup> Referenced in paragraph 90 of Appendix I

<sup>43</sup> Paragraph 92, Appendix I.

- Staff costs are higher in London on average.

15.24. It is therefore our view that the CC has under-estimated the cost effectiveness of this potential remedy.

### **Bidding costs**

15.25. Whilst the private sector will also bear costs of bidding and, for unsuccessful incumbent operators, of re-organising their businesses, these are considered to be at the lower end of the range suggested by the CC. We suggest this assertion is supported by estimates of the costs incurred in bidding for heavy and light rail franchises in the UK<sup>44</sup>. Once established, franchise costs for bidders may well be lower than the costs incurred initially due to the likely economies of scale that could result.

### **Franchise management and supervision**

15.26. While we agree that there are likely to be additional costs for PTEs in supervising franchises and implementing improved bus networks (paragraph 415), many of these will transfer from operators to LTAs and will therefore not result in an increase in the overall net cost of the network. In addition, the move to franchising will allow LTA resources to be realigned given that a number of functions may no longer be required or could be significantly reduced.

15.27. Based on internal estimates, the PTEs consider that the **net** additional costs of supervising and administering a franchise would be negligible. It should be noted that, while the PTEs have no recent experience of franchising commercial services, they have substantial experience of franchising both tendered networks as well as rail and light rail networks.

### **Operating costs**

15.28. We cannot accept the statement in paragraph 419 that franchising has to '*involve substantial additional costs*'. Furthermore, we would argue this is itself an exaggeration of the statement in paragraph 106 of appendix I, which merely states "(...) *franchising (...) is also likely to increase costs*". The evidence presented in the CC's report and submissions from PTEs all indicate that, in terms of like-for-like comparisons<sup>45</sup>, operating costs would remain fairly stable, with some opportunities for overall network efficiencies where service duplication takes places. In essence some costs may move from the operator to the LTA, but with the opportunity for efficiencies through removing duplication.

15.29. Franchising has the potential to address the AEC and deliver wider benefits in addition to that. However, different remedies need to be compared on a like for like basis. It is our expectation that a relatively light touch QC would address the AEC effectively on its own. However, and as the CC recognises, LTAs have a wider policy remit and are also bound by the existing QC legislation to clearly demonstrate that a

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<sup>44</sup> [X]. At the same time, bidding costs for tendered services and for TfL services are likely to be much lower. We would expect bidding costs to be proportional, to some extent, to turnover and expected level of capital investment.

<sup>45</sup> Assuming similar networks and levels of service under franchising and the current market

QC scheme is in the public interest and would reverse the past decline in bus patronage. Hence, it is important to understand that existing QC proposals go beyond what would be required to address the AEC alone and that needs to be clearly taken into account in your assessment.

### **Risks**

- 15.30. We cannot agree with the CC's conclusion '*that there is a significant risk of mis-specification of the franchise network as a result of the change in role for the LTAs*' (paragraph 67 of Appendix I). Initially, LTAs are likely to specify services very similar to those that operated prior to franchising, making more substantial changes (or inviting future operators and bidders to propose changes) only when they have acquired adequate commercial data. The risk of initial mis-specification can be effectively managed with sufficiently flexible contracts to enable services to be adjusted to meet passenger demand during the period of the initial round of contracts.
- 15.31. In terms of the '*information asymmetry*' highlighted in paragraph 56, appendix I, we have argued that the information remedy proposed in the context of tendered networks could easily be extended to franchising of commercial services (see related point in the section relating to the Tendered market remedy). We would therefore strongly encourage the CC to consider this possibility as part of its final determination.
- 15.32. However, it is easy to over-state the case while overlooking the fact that most PTEs carry out a large rolling programme of on-board passenger surveys for the purpose of concessionary reimbursement, which allows them to estimate travel patterns and revenue by ticket type with some degree of accuracy. These surveys can be used to estimate, for example, trip length and mean vehicle occupancy, which are typically beyond the capabilities of the information systems used by incumbent operators. There is clearly a much greater asymmetry of information between incumbents and potential new entrants than between incumbents and PTEs.
- 15.33. It also needs to be acknowledged that PTEs have extensive experience of franchising (and staff well versed in procurement issues) in other markets such as tendered bus networks, as well as rail and light rail networks.
- 15.34. With respect to the cost of the transfer of pension rights and staff terms and conditions, highlighted in paragraph 52, Appendix I, it is made clear in a footnote in the CC's report that this would only become an issue at the point of franchise renewal, and not following the termination of a service freely provided by a commercial operator in a deregulated market.

### **Skills gap and duplication**

- 15.35. The concern over a "skills" gap, referred to in paragraph 409(a), is not a problem we envisage. The PTEs have significant internal resources available, including many individuals with direct experience of employment with major operators in the skills areas highlighted by the CC. In addition, PTEs are experienced at network planning and design through existing work, i.e. tendering of non-commercial services as well as the planning, design, specification and procurement of rail and light rail networks. For example in 2009 Nexus carried out a highly successful large-scale tender exercise

covering the operation of the Tyne and Wear Metro service (valued at circa £40 million per annum) and now manage the resulting contract.

15.36. Importantly we do not consider that there would be need for duplication of this work. In fact moving to franchising may well create overall efficiencies as only one party need retain specialist services. At present each operator will have these skills, duplicating the resource inefficiently.

15.37. Clearly, if skilled staff exist at present they can still function in a franchised market, albeit potentially working for a different employer. TUPE arrangements could be used to facilitate the transfer of these skills. The competition pressure of franchising will ensure that these skills are provided in the most efficient way.

### ***Customer focus and demand responsiveness***

15.38. It is asserted in paragraph 414 that the lack of contact between the LTA and the passenger may reduce demand responsiveness. In the case of PTEs the opposite is quite true, as we are the bodies which interact directly with passengers, which deal with and co-ordinate customer complaints on behalf of all operators, and who operate bus stations/interchanges. This is evidenced by the thousands of complaints from bus users handled by PTEs each year. In addition we co-ordinate and are represented on all passenger forums and attend Parish Council and other local meetings at which passenger concerns are raised. In most PTE areas, the only way in which a passenger could make a complaint in person directly to an operator would be to walk to the gate of its depot.

15.39. Because of our customer facing role, PTEs are often perceived by the travelling public to be the body that actually provides bus services. A franchising model will strengthen this perception and will certainly not reduce the interaction with passengers. Being the franchising authority would heighten the need to be passenger responsive.

15.40. It has also been argued that political influence rather than economic considerations could lead to the inefficient allocation of resources<sup>46</sup>. Although the work of PTEs is overseen by ITAs, which are local democratically accountable bodies, we work within tight budget constraints (very much as private bodies) and have clear and transparent decision making processes based on robust economic analysis which are guided by the wider welfare implications of our actions. This is perfectly illustrated by the QC business case which [redacted] has shared with the CC.

15.41. Furthermore, we would point out that the powers to suspend regulated services are held by an LTA only for a 10 year period, after which it is necessary to justify, under the watchful eye of the independent QC Board, a renewal of these powers. This difference makes bus franchising unlike most other local authority schemes. With the presence of the five statutory public interest criteria – including market growth, value for money and efficiency – in primary legislation, an LTA will need to remain focused on the effective delivery of local policy in an affordable manner throughout the period of the Scheme, and this will act as a strong defence against inappropriate political influence.

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<sup>46</sup> Paragraph 79 (d), Appendix I

### Mitigating the potential risks of franchising

- 15.42. We do recognise that there are potential risks associated with transitional services in the period after the Scheme is made and before the services start to operate, and particularly once contracts are awarded. We believe this is an area where the CC should be making recommendations to the DfT to assist LTAs in managing that risk.
- 15.43. In principle, once a decision to proceed with franchising is made (the ‘making’ of a Quality Contract Scheme, and exhausting any related legal challenges), the commercial sensitivity of information about the routes that will be subject to franchising is much reduced. It is doubtful whether any operators would want to enter a market with such limited prospects. Measures to make commercial data available to LTAs would assist greatly them in managing risk effectively and securing good value for money.
- 15.44. Franchising places a requirement on promoter LTAs to take risks by taking the action necessary to increase bus usage. This implies a requirement to invest in bus services to improve the services for passengers. Thus risk is an inescapable part of the process. However, it encourages LTAs (as it does its suppliers, if appropriate incentives are put into place) to find means by which costs can be reduced in order to create the resources needed to fund required investment. It is by managing costs effectively and putting competition to work to trim profit margins, that LTAs will succeed in creating the financial surplus to generate growth and manage risk.

### The threat of franchising

- 15.45. [redacted].
- 15.46. One important point that has emerged from existing proposals is that the mere threat of QCs appears to have had a moderating role on operator behaviour. In South Yorkshire, for example, this appears to have been the trigger for the two largest operators to agree to come to the table with the PTE and smaller operators to discuss a voluntary partnership agreement requiring substantial changes to timetables and ticketing. In West Yorkshire, the threat of a QC caused local operators to form ABOWY47 and come forward with a number of concrete proposals to improve local bus services. We would therefore argue for the existing legislative framework to be maintained and, if anything, strengthened.
- 15.47. [redacted].

### Points of clarification

- 15.48. With respect to the statements in paragraph 19, Appendix I, we would wish to point out that London has a route franchising model (rather than area franchising)<sup>48</sup> and that the PTEs remain open minded about the most appropriate procurement model for franchised services.

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<sup>47</sup> Association of Bus Operators in West Yorkshire

<sup>48</sup> In paragraph 34, appendix I, the CC states that “*In London, franchising is carried out on a route by route basis with around 15 to 20 % of contracts tendered each year*”.

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## A. **Annex one: Legislative, and associated timescale issues, around the proposed remedies.**

Note: This commentary is informed by specific legal advice on the legislative implications of the CC's proposed remedies.

**Ticketing:** many of these requirements will need implementation through primary legislation, as set out in the Provisional Decision. To the extent that the requirements could be implemented without primary legislation, there are still significant barriers to implementation, as this is likely to require:

- Full co-operation by operators who may have limited incentives to co-operate other than that it may delay implementation of equivalent provisions through primary legislation;
- Review and amendment of the ticketing block exemption by the OfT;
- Implementation using existing statutory procedures, such as statutory quality partnership schemes (SQPs), which are not designed for the specific purpose of implementing ticketing schemes with price control, and therefore would leave LTAs open to significant delivery risks;
- Appropriate funding of the traffic commissioner to ensure that any SPQs that was implemented could be effectively enforced.

**Operator behaviour:** many of these requirements can be implemented through secondary legislation, although it would be preferable for primary legislation to be used where the CC's recommendations go considerably beyond the current use of the legislation. Implementation through secondary legislation would mostly relate to amendments to either the operator licencing regime or the service registration regime. Both of these are likely to require additional funding of the traffic commissioner, as they will impose a further burden on the traffic commissioner, both in respect of licencing and enforcement. The proposed Code of Conduct for operators may take some time to implement – whilst it could potentially be delivered through secondary legislation (by allowing it to be imposed as a condition on operator licences), it is such a significant additional condition to impose, that it may be better to expressly impose it through primary legislation, otherwise there may be a risk that the SoS is challenged for exceeding his authority.

**Bus stations:** the CC intends to implement its recommendations in respect of bus stations through an Order under the Enterprise Act 2002. Primary legislation is not required.

**Supported services:** best practice guidance can be updated and complied with, without any further legislation being passed. The proposed information gathering powers for tendering are likely to require primary legislation to be passed. Operators are likely to wish to see any information release under such legislation restricted to the purposes proposed by the CC in their proposals i.e. LTAs would not be allowed to use the information for other purposes. The proposed voluntary arrangements that the CC suggests should be in place until such legislation is passed will almost certainly have similar restrictions, in line with the data sharing arrangements that LTAs already have with many operators.

**Competition enforcement:** these remedies do not require primary legislation, and relate to changes in OFT behaviour.

**Partnership:** the proposed remedies relate to use of the existing partnership powers. No primary legislation is required.

**BSOG:** the proposed remedies relate to a review of using BSOG to incentivise behaviours under other remedies. No primary legislation is required, but care will need to be taken to ensure that this does not over complicate the BSOG regime, lead to perverse incentives or lead to the BSOG regime breaching EU state aid requirements. The risk of perverse incentives arising will be reduced if sufficient notice is given of any further changes to BSOG to allow LTAs to take such incentives into account when devising their local transport policy. Whether the CC requirements are compliant with state aid rules would require further analysis on the detail of the proposals. The current high level proposals (including requiring compliance with a code of conduct) suggest that the proposals could be in breach of the PSO Regulations, as the incentive payments may not be aligned with the costs incurred by the operators in complying with their obligations. As there is a risk of the amended BSOG scheme not applying on a wholly non-discriminatory basis, there is a risk that such proposals could, in themselves, amount to state aid, or distort the local bus market.

Overall, significant parts of the proposed remedies are only likely to be effective either a) if primary legislation is passed or b) operators are compelled to comply in the spirit of the CC's recommendations. Without any form of compulsion on these requirements, current experience would suggest that there is a significant risk of operators failing to comply with the spirit of the recommendations, and in many cases there appear to be few commercial reasons for them to comply, especially if primary legislation is not forthcoming.

### **Timescales for implementation of primary legislation**

In terms of the risks associated with significant parts of the remedy requiring primary legislation, it is worth considering the actual timescales for such legislation to pass. Whilst typically bills takes a significant period of time to pass into law, this is more a product of what Parliament needs to debate in respect of that bill, through the various stages of the Parliamentary process, rather than due to the Parliamentary process itself taking considerable time. For example, Finance Acts are typically passed in a short period of time (the Finance Act 2010 was passed in 9 days, from First Reading to Royal Assent), but some transport related bills have had much longer passages through Parliament (for example the Crossrail bill took over three years).

Secondly, any timescale for implementation needs to take into account not only the passage of the bill through Parliament, but also the preparation before the bill is placed before Parliament, and the period of time between Royal Assent and the commencement of the relevant sections of the Act. For example, the Local Transport Act 2008 took just over a year to go through Parliament (First reading in the House of Lords on 11 November 2007, Royal Assent on 26 November 2008). However there was both a period of consultation in the year prior to that (e.g. the DfT's report on bus services in February 2007), and a period following royal assent during which many of the provisions had not commenced, whilst guidance was finalised by DfT. For example, some of the quality contract scheme provisions were only introduced by SI 2009/3242, more than a year after the Act received royal assent. This is a potential further delivery risk with the current CC remedy proposals, as they leave room for debate and discussion, with further lobbying over terms by both LTAs and bus operators, which could delay both the passage of any bill through Parliament, and publication of any necessary associated statutory guidance.

So if the Local Transport Act 2008 (the last significant buses legislation) were to be taken as a template, then the process from initial consultation to implementation of related orders,

took two years and nine months. However, this does not take into account the need to find a slot in the Government's annual legislative programme (which cannot be guaranteed) and for the legislation to be used once it is full enacted. This in turn could add several years to the process.