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Consultation response

## **Public Transport Ticketing Schemes Block Exemption Review (OFT)**

October 2010

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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. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions.
- 1.2. Our core responsibilities include:
  - Helping passengers make sense of their public transport network by providing impartial and comprehensive information;
  - Making public transport more affordable by running concessionary fare schemes and by promoting and, in some cases, administering integrated ticketing schemes.
- 1.3. We therefore welcome the opportunity to respond to this consultation document.

## 2. Response

**Question 1. In light of a further period of working with the PTTS Block Exemption since 2006, do you agree that the integrated ticketing schemes indicated above provide economic benefits? Are there any other economic benefits that such schemes provide?** Please note if your answers vary according to the different types of ticket covered and explain how they vary.

- 2.1. Every year, over 100 million bus passengers use ticketing products covered by the PTTS Block Exemption in the English PTE areas alone:
  - In Greater Manchester, 25m bus trips are made using the System One MTC products (corresponding to 18% of all adult non-concessionary bus trips), representing a 3-fold increase over the past 10 years. This is all the more significant given the slight decline in overall demand for bus travel over the same period.
  - In Tyne and Wear, local MTCs are used on 20m bus and metro trips, corresponding to 11% of all adult travel on local public transport.
  - In West Yorkshire, local MTCs (including multi-modal products) are used on 24m bus trips (corresponding to 22% of all adult non-concessionary bus trips). Pre-paid rail tickets (including multi-modal products) are used on 26% of all rail journeys.
  - In Merseyside, the local MTCs are used on 22m bus trips (corresponding to 23% of all adult non-concessionary bus trips). About half of these trips are multi-modal in nature.
- 2.2. This observed level of demand suggests that integrated ticketing schemes provide significant benefits to passengers and society at large, namely:
  - Cheaper and more convenient travel alternatives;
  - Increased perceived frequency on corridors where on-street competition takes place;
  - Reduced congestion and externalities due to reduction in car use.
- 2.3. Operators also stand to benefit through:
  - Increased attraction of passengers who would otherwise travel on competing modes;

- Increased viability of public transport networks;
  - Lower operating costs due to reduced boarding times. Our analysis suggests that if all bus passengers were to switch to pre-paid tickets bus operating costs could fall by 3% due to lower journey times and demand would increase by 3.8%<sup>1</sup>.
- 2.4. In our view, there are two key properties of integrated ticketing schemes which explain their popularity and wider benefits. On the one hand they allow **price differentiation** to take place. Without such products, operators would be unable to identify those passengers who must rely on more than one service and who have therefore higher propensity to switch to competing modes. By singling out those passengers integrated tickets allow operators to lower their mark-up and price closer to marginal cost. It has been shown<sup>2</sup> that, under monopolistic conditions (as could be argued is partly the case for local bus markets), price differentiation leads to a welfare maximising outcome.
- 2.5. The other important feature of integrated ticketing schemes is that they can remove part of the intrinsic complexity in making multi-modal or multi-operator journeys. It has been pointed out by a number of authors<sup>3</sup> that there is a non-negligible **transaction cost** involved in making complex journeys. By removing much of this complexity, integrated tickets can effectively reduce the overall cost (including monetary and non-monetary components) of making a trip. We would argue that, even if integrated schemes were to lead to higher prices<sup>4</sup>, the reduction in transaction costs is likely to outweigh the change in price.

**Question 2.** In light of a further period of working with the PTTS Block Exemption since 2006, do you agree that the ticketing schemes indicated above (MTCs, MITs, TTs), if they satisfy the conditions in the PTTS Block Exemption, do not impose on the undertakings concerned restrictions unnecessary for the attainment of the benefits described above? **In particular, do you agree that fixing the end price for MTCs meets the indispensability condition, or are there other practical alternatives that would lead to equivalent benefits? For example, would alternative revenue sharing agreements that did not involve fixing a common end price for MTCs achieve this end?** If you can envisage other practical alternatives, please describe these in detail.

- 2.6. As pointed out above, it is our view that the simplicity of MTCs is a key economic benefit of this type of product in its own right. There is therefore a case for arguing that fixed price MTCs offer the best solution, all else being equal.

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<sup>1</sup> PTEG (2010), BSOG Devolution – Funding More Effective and Sustainable Bus Networks, Internal Report.

<sup>2</sup> Boiteux M. (1956), Sur la gestion des monopoles publics astreints à l'équilibre budgétaire, *Econometrica* **24** (1956), (published in English as "On the management of public monopolies subject to budgetary constraints". *Journal of Economic Theory* 3, 219–240).

Ramsey, F. (1927), A contribution to the theory of taxation, *Economic Journal* **37/1** (1927).

<sup>3</sup> For a summary, see Bonsall PW, Shires JD, Matthews B, Maule J and Beale J. (2007) Responses to Complex Pricing Signals: Theory, Evidence and Implications for Road Pricing, **Transportation Research A** 41 (A), 672-683.

<sup>4</sup> Our previous discussion on price differentiation actually suggests that integrated tickets are likely to lead to lower prices for those passengers making multi-leg journeys. This issue is addressed again at a later point in our response.

- 2.7. That being said, it could conceivably be beneficial to specific segments of the passenger market if there could be greater price differentiation between multi-operator products, assuming this would lead to MTC prices more closely reflecting variations in the marginal cost of individual travel patterns. For example, there could be obvious benefits from lower cost operators selling MTC tickets which would undercut the common price while agreeing to share a proportion of that revenue with other operators accepting that ticket. However, it is difficult to see how such a system could look commercially attractive to the larger incumbent operators.
- 2.8. In fact, many PTEs have seen significant growth over recent years in the demand for individual operator discounted ticketing products<sup>5</sup>. Our view is that this is part of a strategy by incumbent operators to limit the scope for targeted entry and hence to reduce competition. When passengers buy a single ticket they have the flexibility to make the return journey on a different operator's service. However, return, daily, weekly and monthly tickets give the incumbent operator increasing levels of protection against targeted entry as the passenger is effectively committing not to travel on a competing operators' service for the validity period of that ticket. It is therefore difficult to see how an incumbent operator would agree to open up their market to potential competition by agreeing to take part in an MTC priced below their own pre-paid products.
- 2.9. One context in which the ability to offer lower priced MTCs might be attractive is for several smaller operators to agree between them to sell a lower priced MTC in an attempt to compete with the larger operators(s). Although we suspect there are few practical situations in which this would occur, we would not wish to curtail smaller operators' ability to compete and would therefore support the amendment of the PTTS Block Exemption to cover such schemes.
- 2.10. However, it is important to highlight that whatever potential new provisions are put in place the current tried and tested mechanism for implementing MTCs is not undermined in any way. Given the proportion of passengers who depend on MTCs the risk of not having those would be much greater than the potential benefits from greater price competition.

**Question 3. Are there additional features of these ticketing schemes that should be regarded as indispensable and without which the schemes could not deliver the benefits described above? Please note if your answers vary according to the different types of ticket covered by the PTTS Block Exemption and explain how they vary.**

- 2.11. The OFT lists the indispensable features of ticketing schemes as the ability to set prices, to share revenues and to coordinate timetables. Our view is that the first two items are fundamental for any integrated ticketing scheme to be sustainable.
- 2.12. With respect to coordinated timetables, the benefits to passengers are likely to outweigh any possible disadvantages and this is therefore a desirable feature of ticketing schemes. It is easy to see how evenly spaced services minimise waiting time for passengers, reduce the scope for bus congestion and hence deliver the best possible outcome for passengers.

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<sup>5</sup> In some PTEs, single operator discounted tickets now have a greater market share than either cash fares or MTCs. One particular example is the West Midlands where National Express's Travelcard is used on 50% of all bus trips. In Tyne and Wear, sales of operator prepaid tickets have grown by 57% over the past five years, against a background of relatively stable demand. Merseyside has seen an equivalent growth of 142% against a background of decline in overall patronage.

Therefore, we are not of the view that limiting timetable coordination between two operators in order to preserve the opportunity for a new entrant to come into the market is desirable.

**Question 4. In light of a further period of working with the PTTS Block Exemption since 2006, do you agree that a fair share of the economic benefits provided by the integrated ticketing schemes indicated above are passed on to consumers? If you have identified any additional economic benefits in your answer to question 1 above, do you consider that they are passed on to consumers? Please note if your answers vary according to the different types of ticket covered by the PTTS Block Exemption and explain how they vary.**

- 2.13. If we understand correctly, this question is asking whether, when integrated ticketing schemes lead to higher profitability, this results in lower prices for passengers. It is difficult to give a firm answer without a rigorous analysis of the bus industry's cost structure and pricing strategy, which is largely beyond the remit of the PTEs.
- 2.14. However, if we concentrate exclusively on those passengers benefiting from integrated ticketing schemes then it would appear that the additional economic benefits are being passed through by operators. This conclusion is based on an analysis of the price of MTCs and operators' own discounted products, which shows the difference to be a fraction of the cost of a typical single cash fare<sup>6</sup>. This implies that the premium attributed to an MTC relative to a single operator ticket must very close to marginal cost.

**Question 5. In light of a further period of working with the PTTS Block Exemption since 2006, do you agree that the ticketing schemes indicated above, if they satisfy the conditions in the PTTS Block Exemption, are unlikely to allow the undertakings concerned to eliminate competition in respect of a substantial part of the services in question? Please note if your answer varies according to the different types of ticket covered by the PTTS Block Exemption and explain how it varies.**

- 2.15. As highlighted above (Q2), a number of PTEs have seen significant growth in the market share of operators' own prepaid tickets, which we perceive partly as an attempt to shield from competition. Effectively, MTCs ensure that passengers have an alternative to being locked into operators' own discounted products, thereby removing a significant barrier to entry. In fact we cannot see how an MTC could undermine competition given that any operator wishing to sell a lower priced ticket for their services can do so of their own accord and remain out of the MTC scheme.
- 2.16. This is particularly relevant to tendered services, which, it has been recognised for some time<sup>7</sup>, have been critical for ensuring that the bus market remains contestable. Whilst the commercial bus network can be seen as a spatial oligopoly shared between up to three large

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<sup>6</sup> For example, in Greater Manchester, the weekly System One MTC is priced at £17 whereas the First Manchester weekly ticket is priced at £16. Hence, for an additional £1 a passenger can use the services of any other operator in the area. So it would pay off for a regular First passenger to buy the System One product if they made a single bus trip per week using a different operator.

<sup>7</sup> Mackie, P.J. and Preston, J. (1996), *The Local Bus Market*. Avebury

operators<sup>8</sup>, there are dozens of smaller independent companies in each metropolitan area. Although they run a small proportion of commercial services, such operators are very active in the tendered market. Many tendered services run in the early morning and late evening, just before or after concurrent commercial services, and will therefore share passengers with the commercial operator. Where these tendered services are allocated on a gross cost basis MTCs can promote competition by allowing smaller operators to carry passengers who would otherwise be locked into the incumbent operators' discounted product. This reduces risk and increases revenue and patronage, thereby allowing smaller operators to compete.

- 2.17. This argument is supported by recent analysis by the Competition Commission that number of bidders tends to be higher where integrated tickets are in place.

**Question 6. In light of a further period of working with the PTTS Block Exemption since 2006, do you agree that there is a risk that without the PTTS Block Exemption operators would not choose to participate in the above ticketing schemes, and especially in the establishment of new schemes? If so, do you have any evidence to support this view? Please note if your answers vary according to the different types of ticket covered by the PTTS Block Exemption and explain how they vary.**

- 2.18. The PTEs are in agreement with the OFT's view that "individual operators are unlikely to have an incentive to join [MTC] schemes in the absence of a block exemption, due to concerns that the agreement could risk infringing competition law with the associated risk of exposure to enforcement action under the Act, including financial penalties".
- 2.19. The growth in sales of operators' prepaid tickets (see answer to Q2) further suggests to us that, without the legal framework provided by the PTTS Block Exemption, incumbents may be tempted to further reduce the risk of competition by exiting from integrated ticketing schemes (see answer to Q5).
- 2.20. It is useful to recall the example of the highly popular West Midlands Travelcard, introduced by the local PTE in 1972<sup>9</sup>. By the late 70s this product accounted for nearly a third of all adult fare paying trips. However, deregulation resulted in a very concentrated market, with one operator holding an 85% market share. Since this operator had very limited incentive to share its revenue with prospective competitors the Travelcard was eventually scrapped and only re-introduced following the PTTS Block Exemption.
- 2.21. With the trend towards increasing market concentration, it is conceivable that larger operators will see less and less advantages in supporting multi-operator tickets and so it is critical, in our view, that the regulatory framework does not provide added barriers to integrated ticketing.

**Question 7. Since the PTTS Block Exemption was extended in 2006, have any alternatives to the ticketing schemes covered by the PTTS Block Exemption developed that you think would provide greater benefits to consumers (leaving aside**

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<sup>8</sup> NERA (2006), The decline of bus services in PTE areas. Available: [http://www.pteg.net/NR/ronlyres/94260D61-2AE0-4B51-90D3-5E69BEF1CD6A/0/NERA\\_Decline\\_in\\_Bus\\_Services\\_September\\_2006.pdf](http://www.pteg.net/NR/ronlyres/94260D61-2AE0-4B51-90D3-5E69BEF1CD6A/0/NERA_Decline_in_Bus_Services_September_2006.pdf)

<sup>9</sup> <http://www.pteg.net/NR/ronlyres/77D5B0CC-3513-48FE-95E8-9B236F9416A1/0/integratedticketingreportFINALOct09.doc>

**the issue of so-called 'smart cards', which are discussed in chapter 5 below)? If so, please describe these schemes and explain why they would provide additional benefits.**

2.22. We have no particular comments to this question.

**Question 8. Do you agree with our assessment that it would be premature substantially to change the PTTS Block Exemption to accommodate new modalities of ticketing based on smart technologies while the way in which the commercial application of smart technologies operates is still relatively undeveloped and smart ticketing technologies are not widespread? If you disagree, please: (i) explain why you disagree; and (ii) describe the specific changes you consider should be made to the PTTS Block Exemption.**

2.23. The PTEs agree with the view expressed by the OFT that it is premature to consider changes to the PTTS Block Exemption to accommodate new smart ticketing products. While several PTEs are at a fairly advanced stage of implementation of smart ticketing, it is envisaged that, for the time being, all applications of this technology will fit within either the existing PTTS Block Exemption or fall within the rules of the 1998 Competition Act.

**Question 9. Do you agree with our proposed recommendation to extend the duration of the PTTS Block Exemption for five more years, which takes into account the likely timescale for the developments in smart ticketing? If you disagree, what would in your view be the appropriate duration and why?**

2.24. The PTEs consider a five year extension of the PTTS Block Exemption to be appropriate, given the current stage of development of new smart ticketing products<sup>10</sup>. However, we would reserve the right to call on the OFT to consider any emerging developments on an ad hoc basis as and when they take place.

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<sup>10</sup> Please see the following link for a statement of the status quo on smart ticketing in the PTE areas:  
[http://www.pteg.net/NR/rdonlyres/5E28B85B-5821-48AB-9857-EF7EDF4114EB/0/smartcardstatementfinal\\_2.pdf](http://www.pteg.net/NR/rdonlyres/5E28B85B-5821-48AB-9857-EF7EDF4114EB/0/smartcardstatementfinal_2.pdf)