

Guidance on the application of
competition law to certain aspects
of the bus market following the
Local Transport Act 2008

This guidance is not a substitute for the Transport Act 2000, as amended by the Local Transport Act 2008, or the Competition Act 1998 and it is not a definitive interpretation of the law.¹ It should be read in conjunction with the legislation. The examples or illustrations in this guidance should not be taken as guidance as to the extent of any legal obligations or powers under the Transport Act 2000 as amended by the Local Transport Act 2008. Enquiries as to the extent of any legal obligations or powers under this legislation should be made to the Department for Transport. Anyone in doubt about how they may be affected by the legislation should seek legal advice.

References to specific provisions in the Transport Act 2000 are references to that Act as amended by the Local Transport Act 2008.

¹ This guidance supersedes the OFT's guidance entitled 'The Transport Act 2000 and the Transport Scotland Act 2001' (OFT393) only insofar as that guidance applies to England and Wales. 'The Transport Act 2000 and the Transport Scotland Act 2001' (OFT393) remain good guidance in respect of Scotland.

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1. INTRODUCTION

1.1 This guidance is primarily intended as a guide to assist both local transport authorities² (LTAs) and bus operators which are entering into, or are participating in, a Quality Partnership Scheme (QPS) or other bus partnership agreement, to assess whether the arrangements they are party to (or entering into) comply with competition law. It also considers how competition law applies to certain aspects of the LTAs' functions in the making and varying of ticketing schemes and the inviting and accepting of tenders.

1.2 The guidance is intended to explain:

- when schemes or agreements will fall within the scope of competition law
- which competition test applies in which circumstances, and how to apply the test in each case
- how LTAs and bus operators can satisfy themselves that the schemes or agreements they enter into meet the applicable competition test, and
- the OFT's investigation and enforcement powers in different circumstances.

1.3 This guidance discusses the application of the relevant competition tests in England and Wales only. While it does not directly apply to Scotland, where different transport legislation applies,³ the analytical framework set out in this guidance for assessing competition issues should nevertheless be helpful to bus operators and local authorities in Scotland too. The competition tests do not apply to quality contracts made under quality contracts schemes, or to the powers or duties of LTAs in relation to the provision of information about bus services.

1.4 This guidance is organised as follows:

- Chapter 2 provides an overview of the relevant legislation
- Chapters 3 and 4 explain how the Part 1 and Part 2 competition tests in the Transport Act 2000 ("TA2000") are to be applied

² For these purposes, a 'Local Transport Authority' means either a county council in England, a council of a non-metropolitan district in England comprised in an area for which there is no county council, a Passenger Transport Authority for a passenger transport area in England, or a county council or county borough council in Wales (section 108(4) of the Transport Act 2000). A Passenger Transport Authority is renamed an "Integrated Transport Authority" under the Local Transport Act 2008.

³ The relevant legislation in Scotland is The Transport (Scotland) Act 2001 and Transport (Scotland) Act 2005.

- Chapter 5 provides some practical guidance on how to negotiate agreements as part of a QPS, Voluntary Partnership Agreement (VPA) or Qualifying Agreement
 - Chapters 6 to 8 set out the OFT's powers of investigation and enforcement
 - Chapters 9 and 10 explain the application of competition law to ticketing schemes made under the TA2000, and tenders under the Transport Act 1985, respectively, and
 - The annexes are intended to help illustrate how the Part 1 and Part 2 competition tests might apply given various scenarios.
- 1.5 Separate guidance on VPAs and QPSs will be available on the Department for Transport (DfT) website (www.dft.gov.uk) in due course.

2. THE RELEVANT ARRANGEMENTS AND LEGISLATION

2.1 The following paragraphs describe some of the functions of a LTA⁴ before describing the relevant different competition tests. They do not provide a full explanation of the powers of LTAs under the TA2000 or stipulate how an LTA can and cannot use these powers. Questions regarding the extent of the legal powers and obligations of LTAs may be addressed, in the first instance, to the DfT. These issues are covered in more detail in other guidance published by DfT.

The Transport Act 2000 (as amended)

2.2 The TA2000 requires LTAs in England and Wales to develop local transport policies ‘for the promotion and encouragement of safe, integrated, efficient and economic transport to, from and within their area’ and to carry out their functions so as to implement those policies.⁵

2.3 In order to implement their local transport policies, LTAs have at their disposal a variety of powers. These include:

- making QPSs
- entering into VPAs
- making ticketing schemes, and
- making quality contracts schemes.

2.4 Under a **QPS** a LTA, or two or more LTAs acting jointly, undertake to provide particular facilities (bus stops, bus stations, bus lanes, for example) in the whole or part of their area. Operators of local bus services who wish to use those facilities must, when using them, undertake to provide local services to the particular standards specified in the scheme. These standards might include provisions relating to the quality of vehicles, or requirements on frequencies, timings or maximum fares. Section 118(4) of the TA2000 provides that a bus operator may not use facilities provided under a QPS unless it has given a written undertaking to the appropriate traffic commissioner that, when using the facilities, it will provide the service to the standard specified in the scheme.

2.5 A **VPA** is any voluntary agreement under which a LTA, or two or more LTAs, undertake to provide particular facilities, or to do anything else for

⁴ As provided for by Part 2 of the TA2000 as amended by the Local Transport Act 2008.

⁵ Section 108(1) of the TA2000, as amended by section 8(2) of the Local Transport Act 2008.

the purpose of bringing benefits to persons using local services, within the whole or part of their area, and one or more operators of local services undertake to provide services of a particular standard. It will typically contain similar provisions to those described in the previous paragraph about QPSs although the LTA may, in addition to providing facilities, also “do anything else for the purpose of bringing benefits to persons using local services”.

- 2.6 The main difference between a QPS and a VPA is that the LTA cannot prevent bus operators who are not party to a VPA from using the facilities provided under the agreement. This is because there is no equivalent to section 118(4) of the TA2000 that would require an operator to meet the terms of the VPA before registering services that could run and use the facilities provided in the area covered by the VPA. Similarly, there is no power for the traffic commissioner to take enforcement action against an operator who enters into such an agreement but fails to abide by its terms.
- 2.7 Like QPSs, VPAs may contain provisions which set minimum frequencies, timings and maximum fares. However, the nature of VPAs means that there is no ‘admissible objections’ procedure under which operators can object to the inclusion of such requirements.⁶ The LTA would have no power to impose such requirements - where authorities and operators cannot agree about such standards, they would not be included in a VPA.
- 2.8 A LTA, or two or more LTAs acting together, may make a **ticketing scheme**, which requires operators to make and implement arrangements under which passengers may purchase, in a single transaction, certain types of ticket which cover more than one journey or service.⁷ The descriptions of tickets which may be covered by a ticketing scheme are:
- tickets which entitle the holder to make more than one journey on particular local services. These include *multi-operator travelcards* as defined in the Competition Act 1998 (Public Transport Ticketing

⁶ For further information about QPSs and ‘admissible objections’ see guidance to be published by the DfT in due course.

⁷ The legislation about ticketing schemes in sections 135 – 138 of the TA2000 is not amended by the Local Transport Act 2008.

Schemes Block Exemption) Order 2001 (the block exemption)⁸

- tickets entitling the holder to make a particular journey using two or more local services. These include *through tickets* as defined in the block exemption
- where a particular journey could be made on local services provided by any two or more operators, tickets entitling the holder to make a journey on whichever service the holder chooses. These are defined as *multi-operator individual tickets* in the block exemption, and
- in England and Wales, tickets entitling the holder to travel both on one or more services and on one or more connecting rail or tram services. These may include *short distance add-ons*⁹ or *long distance add-ons*,¹⁰ as defined in the block exemption. Ticketing schemes are considered further in chapter 9 of this guidance.

Overview of the competition tests

2.9 Schedule 10 to the TA2000 contains two separate competition tests, each applying to different kinds of agreement or scheme. A third test is to be found in section 9 of the Competition Act 1998 (“CA98”). This section briefly summarises the different tests and the situations in which each test applies.

2.10 The test in **Part 1 of Schedule 10** to the TA2000 applies to the exercise by LTAs of their functions relating to:

- making and varying QPSs
- making and varying ticketing schemes, and

⁸ Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2001, SI 2001/319 as amended by the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) (Amendment) Order 2005 (SI 2005/3347), taking effect retrospectively from 1 March 2000, grants a block exemption from the Chapter I prohibition contained in the CA98 to certain specified types of ticketing arrangements. An agreement which meets the conditions set out in the block exemption is automatically exempt from the prohibition. The OFT has issued a competition law guideline on the public transport ticketing schemes block exemption (OFT439).

⁹ A ‘short distance add-on’ means a multi-operator travelcard as an add-on to a ticket (or tickets) entitling the holder to make a particular journey on a local public transport service pursuant to an agreement which provides onward travel connections for passengers on complementary services.

¹⁰ A ‘long distance add-on’ means:

- (a) a ticket (or tickets) entitling the holder to make journeys solely on the local public transport services of any one operator;
- (b) a multi-operator travelcard; or
- (c) a through ticket,

each being an add-on to a ticket (or tickets) entitling the holder to make a particular journey on one or more connecting services.

- inviting and accepting tenders for subsidised services under section 89 to 91 of the Transport Act 1985.¹¹

2.11 This test applies *only to the exercise by LTAs of their relevant functions*. It does not apply in relation to any actions that might be undertaken *by a bus operator* in connection with a QPS, ticketing scheme or tender for subsidised services.

2.12 The test in **Part 2 of Schedule 10** applies to VPAs, which are defined in section 153(2) of the TA2000, and also explained in separate DfT guidance. It also applies to certain “qualifying agreements” between bus operators.¹²

2.13 For example, a VPA might include provisions as to minimum frequencies, but it might be left to the bus operators to agree between themselves, independently of the LTA, the times at which each operator will operate services in order to provide those minimum frequencies. This latter agreement would not itself be a VPA if it is made independently of the LTA, but it would be a qualifying agreement. A qualifying agreement which has as its object or effect the prevention, restriction or distortion of competition will be subject to the Part 2 competition test **only** if such agreement is certified by the LTA in accordance with paragraph 18(3) and (4) of Schedule 10 to the TA2000. The legislation provides that the LTA must certify that the agreement is:

- i) in the interests of those using local services in the area of the LTA, and
- ii) does not impose restrictions that are not indispensable to the attainment of the bus improvement objectives.

The bus improvement objectives are defined in paragraph 17(9) of Schedule 10 as:

- securing improvements in the quality of vehicles or facilities used for or in connection with the provision of local services
- securing other improvements in local services of benefit to users of local services, and
- reducing or limiting traffic congestion, noise or air pollution.

¹¹ Subject to certain exceptions, sections 89 to 91 of the Transport Act 1985 provide that an agreement cannot be entered into by a LTA that involves providing a subsidy for the provision of public passenger transport services unless the tender has been awarded following a competitive tendering procedure.

¹² See definition in paragraph 17(4) and (5) of Schedule 10 to the TA2000 as inserted by Schedule 2 to the Local Transport Act 2008.

- 2.14 All other agreements¹³ between bus operators could be caught by the Chapter I prohibition.¹⁴ Where they are caught by section 2 of the CA98, they must satisfy the competition test in section 9 of the CA98 in order to be lawful. Examples where the test in section 9 of the CA98 could be relevant include agreements between bus operators - qualifying agreements - which have not been certified by the LTA in the way described in paragraph 2.13.
- 2.15 None of these competition tests are applicable to quality contracts schemes, though the 'public interest' criteria set out in section 124(1)¹⁵ of the TA2000 must be satisfied before such a scheme can be made¹⁶. The competition tests in Part 1 and Part 2 of Schedule 10 and the test in section 9 of the CA98 are unlikely to apply to the powers or duties of LTAs in relation to the provision of information about bus services.
- 2.16 Where the relevant competition test is met, the agreement, scheme or proposed scheme will be deemed to be compliant with UK competition law. The Part 1 test does not apply where the agreement falls within Part 2 of Schedule 10, and the Part 2 test does not apply to the exercise by a LTA of the functions covered by Part 1.¹⁷
- 2.17 The Part 1 and Part 2 competition tests are described in detail in the chapters that follow, while the test in section 9 of the CA98 is described in Box 2 later on in this chapter. Summary Box 1 below sets out the competition test that is relevant to each particular type of scheme.

¹³ 'Agreement' in the context of the test in section 2 of the CA98 means an agreement between undertakings, decision by an association of undertakings or concerted practice. See also the OFT's competition law guideline '*Agreements and Concerted Practices*' (OFT401) which includes a discussion on the meaning of the term 'agreement'.

¹⁴ Section 2 of the Competition Act 1998 prohibits agreements which may affect trade within the United Kingdom and have as their object or effect the appreciable prevention, restriction or distortion of competition within the United Kingdom, unless exempt under the CA98.

¹⁵ As to be amended by section 19(2) of the Local Transport Act 2008.

¹⁶ DfT will publish separate guidance about Quality Contracts Schemes in due course when the appropriate provisions come into force.

¹⁷ Article 81 of the EC treaty will apply where the agreement has an effect (or a potential effect) on trade between Member States. In addition, the Chapter I prohibition will apply to agreements that fall within the Part 2 test in so far as they contain restrictions that fix prices.

Summary Box 1: Which competition test applies?

Type of scheme	Relevant competition test
VPA as defined in section 153 of the TA2000	Competition test in Part 2 of Schedule 10 to the TA2000
Qualifying Agreements, as defined in paragraph 17(4)(a) of Schedule 10 to the TA2000, where the LTA has certified that they are in the public interest and that any restrictions on competition they contain are indispensable to attaining the bus improvement objectives	Competition test in Part 2 of Schedule 10 to the TA2000
QPS as defined in section 114 of the TA2000	Competition test in Part 1 of Schedule 10 to the TA2000 applies to the exercise by a LTA of its functions
Ticketing scheme as defined in section 135 of the TA2000	
Tenders as defined in section 89 of the Transport Act 1985	
Any qualifying agreement between bus operators which has not been certified by the LTA	Competition test in section 9 of the CA98
Quality Contracts scheme as defined in section 124 of the TA2000	The 'public interest' criteria in section 124(1) of the TA2000 must be satisfied

2.18 The remainder of this section provides an overview of the CA98 and the Enterprise Act 2002.

Other competition scrutiny

The Competition Act 1998

2.19 The CA98 prohibits:

- agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the United Kingdom and which have as their object or effect the prevention, restriction or distortion of competition in the United Kingdom (or a part thereof) (the Chapter I prohibition),¹⁸ and
- conduct by one or more undertakings which amounts to the abuse of a dominant position in a market in the United Kingdom

¹⁸ See section 2 of the CA98.

(or part thereof) and which may affect trade within the United Kingdom (the Chapter II prohibition).¹⁹

- 2.20 The concept of an undertaking covers any legal or natural person engaged in economic activity, regardless of its legal status and the way in which it is financed. It has, for example, been held that any activity consisting in offering goods and services on a given market is an economic activity. Competition rules do not, however, apply to activity which, by its nature, aim and the rules to which it is subject is connected with the exercise of the powers of a public authority.
- 2.21 Thus, LTAs will only constitute undertakings for the purposes of the CA98 to the extent that they are engaging in economic activities in a given market. A bus company which is owned by a local authority is likely to be an undertaking. For example, in the OFT's decision CA98/01/2008, the Local Authority-owned bus operator Cardiff Bus, was considered to be an undertaking on the basis that it was “engaged in competing directly in the market with other commercial bus providers”. The exercise of a relevant function by the LTA under the TA2000 will not normally be subject to the CA98. It is also unlikely, in most circumstances, that a LTA through its usual involvement with local bus transport would be an undertaking for the purposes of the CA98.²⁰
- 2.22 The Chapter I prohibition is disapplied by paragraph 20(2) of Schedule 10 to the TA2000 in respect of VPAs and qualifying agreements that fall within Part 2 of Schedule 10,²¹ or in respect of other agreements that meet the test in section 9 of the CA98 (described in Summary Box 2 below).
- 2.23 An undertaking that holds a dominant position in a market is subject to the Chapter II prohibition of the CA98. The Chapter II prohibition prohibits any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position. The Chapter II prohibition applies only to the *abuse* of a dominant position; dominance in itself is not prohibited. Abuse of a dominant position by an undertaking in relation to a QPS would be assessed in the same way as any other type of conduct under the Chapter II prohibition. The Chapter II prohibition is

¹⁹ See section 18 of the CA98.

²⁰ See OFT competition law guideline *Agreements and Concerted Practices* (OFT 401), paragraph 2.5. Further analysis of when public bodies may be undertakings for the purposes of competition law can be found in the OFT's policy note entitled '*The Competition Act 1998 and public bodies*' Policy note 1/2004.

²¹ See paragraph 20(2) of Schedule 10 to the TA2000. Where a VPA as defined in section 153 of the TA2000, or a qualifying agreement (see paragraph 17(4) of Schedule 10 to the TA2000) to which Part 2 of the Schedule applies (see paragraph 18(3) of that Schedule), does not meet the Part 2 competition test, those provisions of the CA98 described in paragraph 23(2) of Schedule 10 will apply.

considered in more detail in the OFT competition law guideline *Abuse of a dominant position* (OFT402).

Summary Box 2: The competition test in section 9 of the CA98

An agreement is exempt from the Chapter I prohibition if it passes the competition test set out in section 9 of the CA98. An agreement passes this test if it:

(a) contributes to

- (i) improving production or distribution, or
- (ii) promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit; and

(b) does not

- (i) impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives, or
- (ii) afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the products in question.

Enterprise Act 2002

2.24 The OFT may make a reference to the Competition Commission under the Enterprise Act 2002 where it has reasonable grounds to suspect that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or part of the United Kingdom. If a reference is made, the Competition Commission will decide whether there is any prevention, restriction or distortion of competition and if so, what remedies may be appropriate.

2.25 Further information on market investigation references is available in guidance published by the OFT (*Market investigation references*),²² and the Competition Commission (*Market investigation references*).²³

²² OFT competition law guideline *Market investigation references* (OFT511).

²³ Market investigation references: Competition Commission Guidelines (CC3).

Mergers

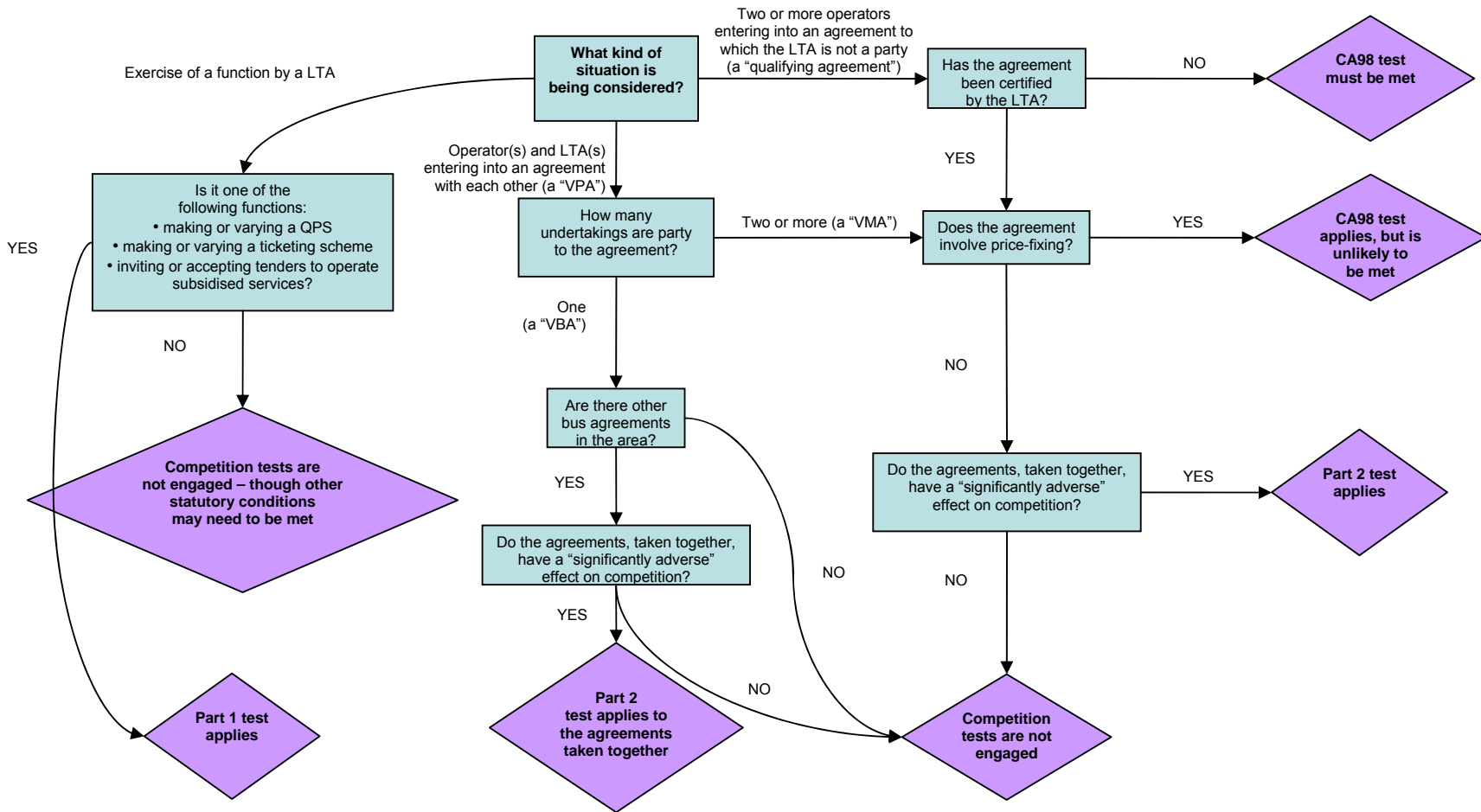
- 2.26 In addition, the OFT may investigate mergers under the Enterprise Act 2002 which meet either the 'turnover test' or the 'share of supply test'. The turnover test is met if the target company has a UK turnover exceeding £70 million. The share of supply test is met if the merging parties will together supply at least 25 per cent of goods or services of a particular description, either in the UK as a whole or in a substantial part of it. This test is only met if the share of supply increases as a result of the merger.
- 2.27 Further information on mergers is available in guidance published by the OFT (Mergers – procedural guidance).²⁴

Articles 81 and 82

- 2.28 Article 81 of the European Community (EC) Treaty²⁵ prohibits agreements between undertakings which have the object or effect of preventing, restricting or distorting competition within the common market and may affect trade between EC Member States. Article 82 of the EC Treaty prohibits any abuse by one or more undertakings of a dominant position within the common market or a substantial part of it in so far as it may affect trade between EC Member States. The changes to the legislation brought about by the Local Transport Act 2008 do not affect the application of Articles 81 and 82.

²⁴ OFT competition law guideline *Mergers – procedural guidance* (OFT526).

²⁵ The Treaty establishing the European Community.



3. APPLYING THE 'PART 1' COMPETITION TEST TO QUALITY PARTNERSHIP SCHEMES

3.1 A QPS is a scheme where a LTA provides particular facilities, and bus operators who wish to use those facilities **must** undertake to provide local services of a particular standard. Changes to the TA2000 contained in the Local Transport Act 2008 will enable authorities to specify requirements as to the frequency and timing of services, and maximum fares, as standards of service. It will also be possible for LTAs to restrict, in certain circumstances, the registration of new services, and the variation or withdrawal of existing ones, within the area covered by the scheme (see the DfT QPS guidance).

The Part 1 test

3.2 The competition test applicable to the local authority functions of making or varying a QPS is set out in Part 1 of Schedule 10 to the TA2000. For a QPS, there are three distinct stages to the competition test:

- is there a significantly adverse effect on competition?
- is the exercise of the LTA's function with a view to securing one or more of the three purposes specified in Part 1?, and
- is the effect on competition proportionate or likely to be proportionate to the achievement of that purpose?

3.3 Each of these stages is considered in detail below.

First stage: is there a significantly adverse effect on competition?

3.4 If the QPS does not have a significantly adverse effect on competition then the Part 1 test is met at the first stage. If, however, the QPS does have a significantly adverse effect on competition, or is likely to have such an effect, the second and third stages below must be considered before the Part 1 test can be met.

Significantly adverse effect on competition

- 3.5 The LTA will have to consider what the relevant market²⁶ might be and the likely effect on competition that would - or would be likely to - result from the making of a QPS. The test is not simply whether there is an effect on competition but whether there is a *significantly adverse* effect on competition. What is to be regarded as a significantly adverse effect on competition is likely to depend on the nature of the restriction of competition and the position of the parties in the relevant market. This may be an effect on actual or potential competition.
- 3.6 A QPS is more likely to have a significantly adverse effect on competition in cases where the likely parties to the QPS possess a substantial degree of market power. One indicator of market power is the market share held by the parties.²⁷ While a QPS is less likely to have a significantly adverse effect on competition if, for example, the combined market share of the bus operators which are party to the QPS is low there is still likely to be a significantly adverse effect on competition if:
- the QPS involves a serious restriction of competition, such as directly or indirectly fixing prices or sharing markets (for example, by virtue of the inclusion of provisions relating to frequencies, timings or maximum fares), or because the QPS includes provisions that would restrict the registration of additional services within the QPS area in specified circumstances (see the DfT QPS guidance), or
 - the QPS is one of a number of similar schemes and/or other agreements between bus operators which have a cumulative effect on the market in question.
- 3.7 Conversely, a QPS in circumstances where bus operators have a high combined market share may be less likely to have a significantly adverse effect on competition if there are low barriers to entry. For example, new entrants may be able to enter the relevant market or existing competitors might be able to switch resources from other routes to compete on the route(s) in question in response to the changed market circumstances in a relatively short time frame.
- 3.8 If a QPS has a significantly adverse effect on competition (actual or potential), it will not satisfy the first stage of the Part 1 competition test and it will be necessary to satisfy both of the two further stages of the

²⁶ See OFT competition law guideline *Market Definition* (OFT403).

²⁷ The OFT's competition law guideline *Assessment of Market Power* (OFT415) describes in more detail how to carry out such an assessment as well as providing some guidance as to what sort of evidence is relevant.

test. An agreement that does not satisfy the first stage of the Part 1 competition test is not automatically prohibited and will be lawful provided the second and third stages of the Part 1 competition test are satisfied.

Second stage: is the exercise of the LTA's function with a view to securing one of the three purposes specified in Part 1?

3.9 A QPS which has a significantly adverse effect on competition will satisfy the second stage of the Part 1 test if it is set up with a view to achieving one or more of the three purposes specified in paragraph 2(3) of Schedule 10. These are set out and described in more detail in paragraph 3.10 below.

3.10 The second stage will be satisfied if the intended purpose of the QPS is to:

- **EITHER** secure improvements in the quality of vehicles or facilities used for or in connection with the provision of local services. This could, for example, be achieved by:
 - requiring the early introduction of vehicles that comply with the standards prescribed in the Public Service Vehicles Accessibility Regulations 2000 by specifying newer vehicles with wheelchair access or low or flat floor buses, providing better access for disabled passengers and passengers with children, or
 - providing bus stops fitted with electronic displays showing real time information about waiting times
- **OR** secure other improvements in local services of benefit to users of local services. This could, for example, be achieved by:
 - providing more reliable services at greater frequency, or
 - providing greater integration of services between different types of transport, or
 - providing journey time savings,
- **OR** reduce or limit traffic congestion, noise or air pollution. This could, for example, be achieved by:
 - requiring the use of vehicles that comply with more stringent emissions standards than those required by law, or

- taking other steps to encourage more people to use public transport instead of private cars, leading to less pollution and/or congestion from private vehicles.
- 3.11 The benefits in respect of this last specified purpose may accrue to the public at large and not just to the users of the services.
- 3.12 It is possible that a QPS may meet more than one of the purposes specified: for example, an improvement in the quality of bus services may also reduce pollution and improve air quality by encouraging increased use of public transport.
- 3.13 In principle, it is likely that a LTA would wish to make a QPS that achieved at least one of the three purposes set out above, so this second stage of the test should not normally present a significant hurdle to a QPS passing the Part 1 competition test.

Third stage: is the effect on competition proportionate or likely to be proportionate to the achievement of that purpose or any of those purposes?

- 3.14 Where a QPS has a significantly adverse effect on competition, for the third stage of the test to be satisfied the adverse effect on competition must be - or be likely to be - 'proportionate' to the achievement of the purpose(s). This means that any measures must not be more restrictive than is reasonably necessary, having regard to the relevant circumstances, for attaining the desired result. That is, can the purpose be achieved by other, less restrictive means? Where a QPS meets the first, second or third purposes set out above relating to improvements in services, the assessment of proportionality will involve the following two-step approach:
- the first step requires an assessment of whether the benefits outweigh, or are likely to outweigh, the detriment to competition
 - the second step involves a consideration of whether those parts of the scheme which result in a significantly adverse effect on competition are reasonably necessary to achieve the purpose(s) specified.
- 3.15 As well as considering the question of whether the benefits are sufficient to justify the adverse effects on competition, the LTA must be satisfied that any restriction of competition is reasonably necessary to achieve the intended benefits to passengers that are expected to arise from the scheme. For example, a scheme may be set up with the intention of securing a higher standard of vehicles on a particular bus route, in order to (a) improve the quality of service for existing

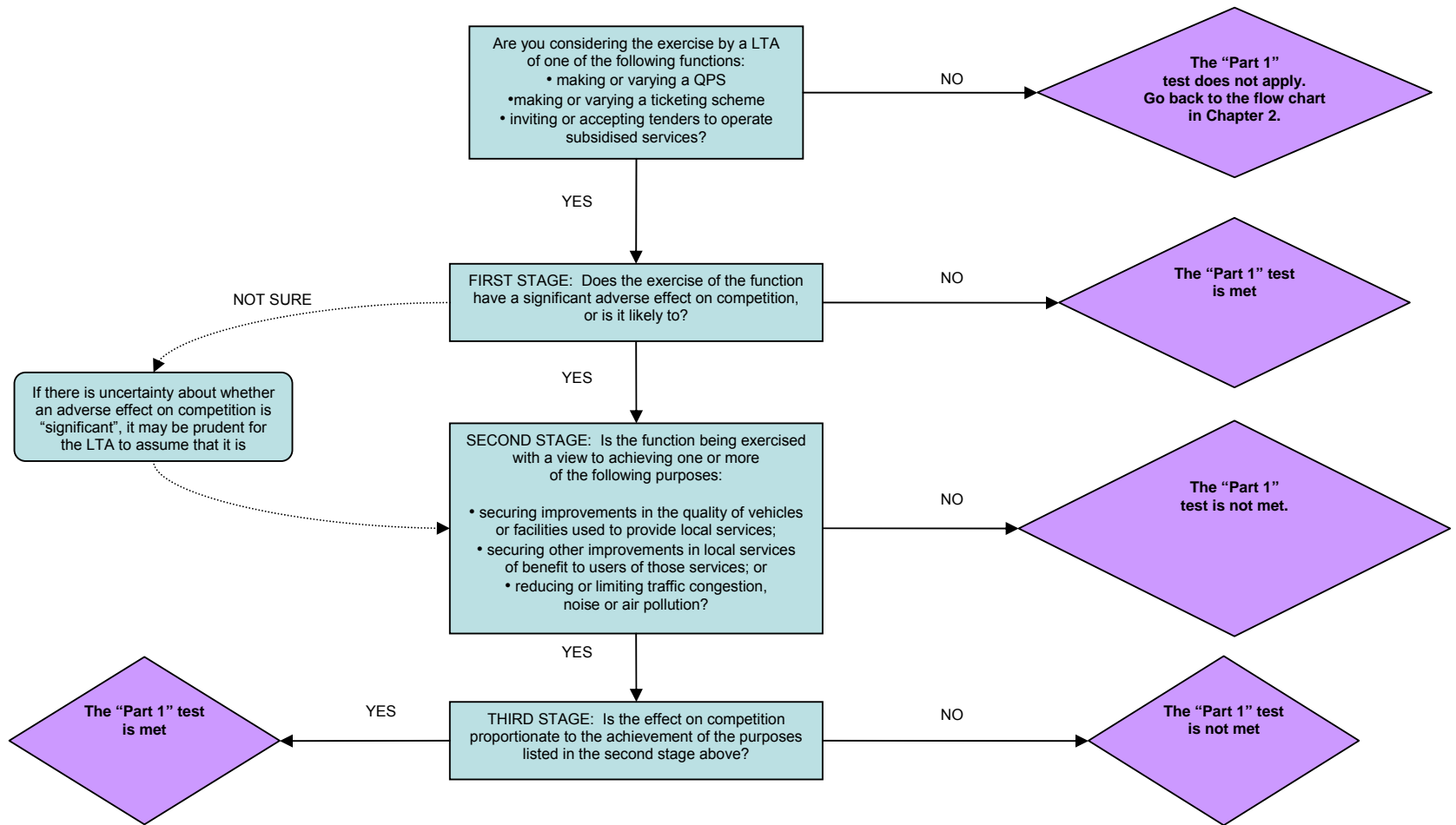
passengers, and (b) to encourage more passengers onto buses and so reduce traffic congestion. The scheme might therefore include particular requirements on vehicle standards. In this case, the LTA would need to be clear whether, if the scheme were amended so that it did not include any restrictions on vehicle standards, the likely benefits of the scheme would be significantly reduced. In other words, would the result be that existing passengers would enjoy significantly lower benefits, and would significantly fewer people be encouraged to take the bus instead of their car? If “yes”, then in this case the restriction on vehicle standards is likely to be “reasonably necessary”.

Conclusion

- 3.16 Where there is a significantly adverse effect on competition, the Part 1 competition test is met where all of the above conditions are satisfied.²⁸
- 3.17 A detailed example of the application of the Part 1 competition test to a QPS is set out at Annex B.

²⁸ See Chapter 8 which sets out the OFT’s powers of enforcement where the Part 1 test is not satisfied.

The “Part 1” test



4. APPLYING THE PART 2 COMPETITION TEST TO VPAs AND QUALIFYING AGREEMENTS

- 4.1 This chapter describes and explains the Part 2 competition test.
- 4.2 Paragraph 20(1) of Schedule 10 to the TA2000 provides that any voluntary multilateral agreement (“VMA”), voluntary bilateral agreement (“VBA”), or qualifying agreement to which Part 2 of the Schedule applies, is prohibited unless it is an exempt agreement. An agreement is an exempt agreement if it satisfies the appropriate test (“the Part 2 competition test”) in paragraph 22 of Schedule 10.
- 4.3 If it does not satisfy the Part 2 competition test, the provisions of the CA98 specified in paragraph 23(2) of Schedule 10²⁹ apply in the same way as they would apply in relation to the Chapter I prohibition.³⁰ This ensures that the OFT has the power to investigate and take appropriate action in respect of an agreement prohibited under paragraph 20(1) of Schedule 10. However, the effect of paragraph 23(2) is that the powers of the OFT under the CA98 to impose financial penalties do not apply to a party to an agreement which is subject to the Part 2 test, but which has failed to satisfy that test.
- 4.4 Annex C of this guidance provides a worked example of how the Part 2 competition test might be applied to a VPA.
- 4.5 Summary box 3 (at the end of this chapter) also briefly explains the provisions of Article 81 of the EC Treaty which might, in certain circumstances, also need to be considered.

Does the "Part 2" competition test apply to a single voluntary bilateral agreement?

- 4.6 No. The test does not apply to a voluntary agreement between only one bus operator and one or more local authorities (a VBA). This is because such an agreement will not normally constitute an agreement between undertakings and would not therefore be subject to the Chapter I prohibition.

²⁹ In particular, these provisions include the OFT's powers of investigation and enforcement.

³⁰ The Chapter I prohibition applies to agreements, decisions of associations of undertakings and concerted practices which have as their object or effect the (appreciable) prevention, restriction or distortion of competition and which may affect trade within the United Kingdom. Such agreements are exempt from the Chapter I prohibition if they pass the competition test set out in section 9 of the CA98 as described in Summary Box 2 below.

4.7 However, it is necessary to consider whether a VBA, when taken together with one or more other VMAs, other VBAs, or qualifying agreements could have an effect on competition.³¹ If it could, then the Part 2 competition test will need to be satisfied in relation to the group of agreements. For example, care must be taken to avoid exchanging confidential information that is unnecessary for the attainment of one or more of the bus improvement objectives.

What are the stages of the "Part 2" competition test for VPAs?

4.8 There are four distinct stages to the Part 2 competition test as it applies to VPAs and qualifying agreements which have been certified by the LTA (see paragraph 4.9 below). First, an assessment must be made as to whether the test actually applies by asking whether:

- the agreement has as its object or effect the prevention, restriction or distortion of competition in the area of the local authority or combined area of the authorities?³²
- does the agreement contribute to the attainment of one or more of the bus improvement objectives? The bus improvement objectives are defined in paragraph 17(9) of Schedule 10 (see paragraph 2.13 above and paragraph 4.20 below). If not, the competition test cannot be met
- does the agreement impose on the undertakings concerned restrictions which are not indispensable to the attainment of those objectives? If so, the competition test cannot be met
- does the agreement afford the undertakings involved in the agreement the possibility of eliminating competition in respect of a substantial³³ part of the services in question? If so, the competition test cannot be met.

What are the stages of the Part 2 test that are relevant for qualifying agreements?

4.9 Where the agreement is a qualifying agreement (an agreement between bus operators only), an extra stage applies. If the agreement satisfies the first stage in the Part 2 test (see bullet 1 in paragraph 4.8 above) it must, if it is to fall within the scope of the Part 2 competition test, have

³¹ See paragraph 18(5) of Schedule 10 to the TA2000.

³² If it does not, the agreement is not one to which Part 2 of Schedule 10 applies and no further action need be taken. If it does, the questions set out in the following bullet points need to be considered too.

³³ See, for instance, *Opinion of the Office of Fair Trading - guidance to facilitate self-assessment under the Competition Act 1998* (OFT1025), paragraphs 4.118 to 4.120.

certification from the LTA (or LTAs where appropriate) that, in their opinion, certain requirements are satisfied. Those requirements are that the agreement:

- is in the interests of passengers using local services in the relevant local authority area, and
- does not impose on the undertakings concerned restrictions that are not indispensable to the attainment of the bus improvement objectives.³⁴

4.10 If the qualifying agreement has the necessary certification from the LTA it is an agreement to which the Part 2 competition test applies. The second, third and fourth stages of the Part 2 test must then also be satisfied in full. If the necessary certification is not forthcoming from the LTA then the agreement is not an agreement to which the Part 2 test applies. Instead, the agreement will be subject to the Chapter I prohibition contained in the CA98 (and will therefore need to meet the competition test in section 9 of that Act).

Detailed consideration of the Part 2 competition test

4.11 Each of the stages described in paragraph 4.8 above is considered in more detail below.

First stage: does the agreement have as its object or effect the (appreciable) prevention, restriction or distortion of competition in the area of the local authority?

4.12 The first consideration is to decide whether an agreement is one to which the Part 2 test applies. The question is whether the agreement has as its object or effect the prevention, restriction, or distortion of competition in the area of the local authority.

4.13 If there is a restriction of competition by **object** in an agreement it is not necessary to demonstrate an effect on competition for the Part 2 competition test to apply. Where an agreement does not have as its object the restriction of competition, it may still have a restrictive **effect**. If an agreement does not have as its object a restriction of competition, consideration must therefore be given to whether the agreement has or is likely to have any restrictive effect in the area of the local authority. In this regard, any agreement between bus operators and one or more LTA(s) might be said to have the effect of restricting the freedom of action of the parties. However, not every restriction of freedom amounts

³⁴ See paragraph 18(4) of Schedule 10 to the TA2000.

to a restriction of competition. What matters, for the purposes of the Part 2 competition test, is whether the agreement has, or is likely to have, a negative effect on prices, output, innovation or the variety or quality of services on the market. Furthermore, the effect must be **appreciable**. Where an agreement has an effect on competition but that effect is not appreciable, then the agreement is not one to which the Part 2 competition test applies, and there is no need to consider the test further.

How do I know whether or not an effect on competition is "appreciable"?

4.14 The concept of appreciable effect is imported from EC law.³⁵ In coming to a view on whether an agreement has (or is likely to have) an appreciable effect on competition for the purposes of the Part 2 competition test, the parties to such an agreement may find it helpful to consider the European Commission's approach as set out in the *Notice on Agreements of Minor Importance*. The OFT competition law guideline *Agreements and concerted practices* (OFT401) also contains further guidance on what is meant by appreciable effect.

4.15 The European Commission's Notice on Agreements of Minor Importance³⁶ sets out, using market share thresholds, what in the Commission's view is **not** an appreciable restriction of competition under Article 81. The European Commission considers that agreements between undertakings which affect trade between Member States do not appreciably restrict competition within the meaning of Article 81 where:³⁷

- the aggregate market share of the parties to the agreement does not exceed 10 per cent on any of the "relevant markets" affected by the agreement where the agreement is made between competing undertakings (that is, undertakings which are actual or potential competitors on any of the markets concerned), or
- the market share of each of the parties to the agreement does not exceed 15 per cent on any of the "relevant markets" affected by the agreement where the agreement is made between non-competing undertakings, (that is, undertakings which are neither actual nor

³⁵ Paragraph 23 of Schedule 10 to the TA2000 applies certain provisions of the CA98 to the application and enforcement of the Part 2 competition test. This includes section 60 of the CA98 which requires that, so far as is possible, questions arising under Part 1 of the CA98 in relation to competition within the UK are dealt with in a manner which is consistent with the treatment of corresponding questions arising in Community law in relation to competition within the European Community. This includes the concept of what is an appreciable effect.

³⁶ OJ C368,22.12.01

³⁷ It is likely that the market will be fairly narrowly defined, see paragraph 4.18.

potential competitors on any of the markets concerned because they are not operating at the same level of the market).

- 4.16 The mere fact that the undertakings' market shares exceed the above thresholds does not necessarily mean that there will be an appreciable effect on competition. In order to assess whether any agreement has an appreciable effect on competition, all relevant factors must be considered, including the market position of the parties, the content of the agreement, the structure of the market or markets affected by the scheme, and the actual and potential competitive constraints on the parties. In particular, factors such as entry conditions and the extent to which there are barriers to entry³⁸ should be looked at.
- 4.17 When applying the market share thresholds discussed above, the relevant market share will be the market share of the parties to the agreement. The OFT competition law guideline *Market Definition* (OFT403) provides a more detailed explanation of the market definition process.

The OFT's recommended approach

- 4.18 Defining the relevant market is the first step in establishing whether an agreement is likely to have an appreciable effect on competition. The OFT competition law guideline *Market Definition* provides a conceptual framework to help identify the likeliest market definition for any particular case. In some cases, there may be a number of equally plausible market definitions that could be employed. However, in most cases it is likely that the market would be fairly narrowly defined (see paragraphs 3.5 to 3.8 in the previous chapter). Where there is a narrow market definition, it is more likely that the thresholds set out in paragraph 4.15 will be exceeded and there will be some form of market power in that market. This suggests that, in most cases, the Part 2 competition test will have to be satisfied. In cases of uncertainty, parties to an agreement should ensure that the agreement meets the second, third and fourth stages of the Part 2 competition test, described in more detail below.

Second stage: does the agreement contribute to the attainment of one or more of the bus improvement objectives?

- 4.19 To pass the second stage of the Part 2 competition test, an agreement to which the Part 2 competition test applies must contribute to the attainment of one or more of the bus improvement objectives as defined in paragraph 17(9) of Schedule 10.

³⁸ OFT competition law guideline *Assessment of market power* (OFT415).

4.20 The bus improvement objectives are:

- securing improvements in the quality of vehicles or facilities used for or in connection with the provision of local services
- securing other improvements in local services of benefit to users of local services, and
- reducing or limiting traffic congestion, noise or air pollution.

4.21 These three objectives are the same as the 'purposes' described in paragraphs 3.10 above for QPSs (see paragraph 2(3) of Schedule 10). In practice, it is unlikely that a LTA would wish to enter into a VPA or certify an agreement between bus operators that did not contribute to the attainment of at least one of these objectives.

Third stage: does the agreement impose on the undertakings concerned restrictions which are not indispensable to the attainment of the objectives?

4.22 In order to meet the Part 2 competition test, an agreement may impose restrictions on competition only where those restrictions are indispensable to the attainment of the bus improvement objectives (as defined above in paragraph 4.20).

4.23 This "indispensability" test has its origins in EC legislation, and the European Commission has published Guidelines on the application of this test in the context of Article 81(3) of the EC Treaty.³⁹ The OFT is required to have regard to these Guidelines when considering the application of Article 81(3) and section 9(1) of the CA98.⁴⁰ In coming to a view on whether an agreement meets this test, the parties may find it helpful to consider the Guidelines and the OFT competition law guideline *Agreements and Concerted Practices* (OFT401).⁴¹

4.24 The decisive factor, in relation to the indispensability test, is whether more efficiencies are produced with the agreement or restriction than in the absence of the agreement or restriction. Efficiencies in this context can be taken to mean improvements to the quality of bus services that benefit passengers and therefore also the bus improvement objectives considered at the second stage.

4.25 The question for the application of the indispensability test is one of "reasonable necessity". This does not amount to an "only practicable way" test. Undertakings are not required to consider hypothetical or

³⁹ Communication from the Commission: Guidelines on the application of Article 81(3) of the Treaty OJ C101 27.4.2004 p 97.

⁴⁰ OFT competition law guideline *Agreements and Concerted Practices* (OFT401), paragraph 5.5.

⁴¹ See also Opinion of the Office of Fair Trading – guidance to facilitate self-assessment under the Competition Act 1998 (OFT1025), paragraph 4.95.

theoretical alternatives but only to consider why seemingly realistic and significantly less restrictive alternatives to the agreement would be significantly less efficient (i.e. would deliver significantly lower benefits to passengers).⁴²

- 4.26 Normally, the need for a VPA or qualifying agreement may have arisen precisely because competition in the market, by itself, has failed to deliver particular benefits to passengers; and the purpose of the agreement will be to deliver those benefits. In this situation, the agreement as a whole is likely to be indispensable to the achievement of the benefits because in the absence of the agreement, the desired benefits to passengers are unlikely to be achieved.
- 4.27 The question then is whether each of the individual restrictions of competition in the agreement is reasonably necessary and so meets the "indispensability" test. Unless the bus improvement objectives could still largely be achieved if one or more of the restrictions was removed from the agreement, the test should normally be met.
- 4.28 For example, a restriction along the lines of "A will operate services at xx00 and xx30; B will operate at xx15 and xx45" is likely to be "indispensable" if the purpose is to provide services at evenly-spaced intervals and so secure improvements in local services (assuming the market is not already delivering evenly-spaced intervals without the VPA). By contrast, if a VPA applying in one particular place contained an additional provision saying the operators will not compete with each other elsewhere in the country, that restriction is unlikely to be "indispensable" to the provision of the benefits.
- 4.29 Some more examples to illustrate how the Part 2 competition test might apply in practice are provided in Annex C of this guidance.

Fourth stage: does the agreement eliminate competition in respect of a substantial part of the services in question?

- 4.30 The application of the fourth stage requires an analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint.
- 4.31 While sources of **actual** competition are usually the most important (as they are most easily verified) sources of **potential** competition must

⁴² See, for instance, Communication from the Commission: Guidelines on the Application of Article 81(3) of the Treaty, footnote 39 above, paragraphs 73-75.

also be taken into account. The assessment of potential competition requires an analysis of barriers to entry facing undertakings that are not already competing within the relevant market.

- 4.32 If the agreement affords the parties the possibility of eliminating competition in respect of a substantial part of the services in question, then the Part 2 competition test will not be satisfied. Again, this might be best understood with reference to the examples in Annex C.
- 4.33 If all of these stages are satisfied then the Part 2 competition test is met.

Summary box 3: Article 81 of the EC Treaty

Article 81 of the EC Treaty prohibits agreements between undertakings,⁴³ decisions of associations of undertakings and concerted practices which have the object or effect of restricting competition and may affect trade between EC Member States. Although it may be unlikely that Article 81 will apply in most cases, parties to an agreement to which the Part 2 test applies will need to consider whether there may be an effect on trade between Member States as a result of the agreement and, if so, ensure that it does not breach Article 81.

The possible application of Article 81 to any agreement is not affected by the application of the Part 2 competition test. The Part 2 competition test is however modelled on the relevant provisions of the Chapter I prohibition and Article 81. Where an agreement meets the Part 2 competition test it is likely that it will also satisfy the criteria for exemption set out in Article 81(3) and therefore will not breach the prohibition in Article 81. Participants in any such agreement should nevertheless satisfy themselves that it is not in breach of Article 81.

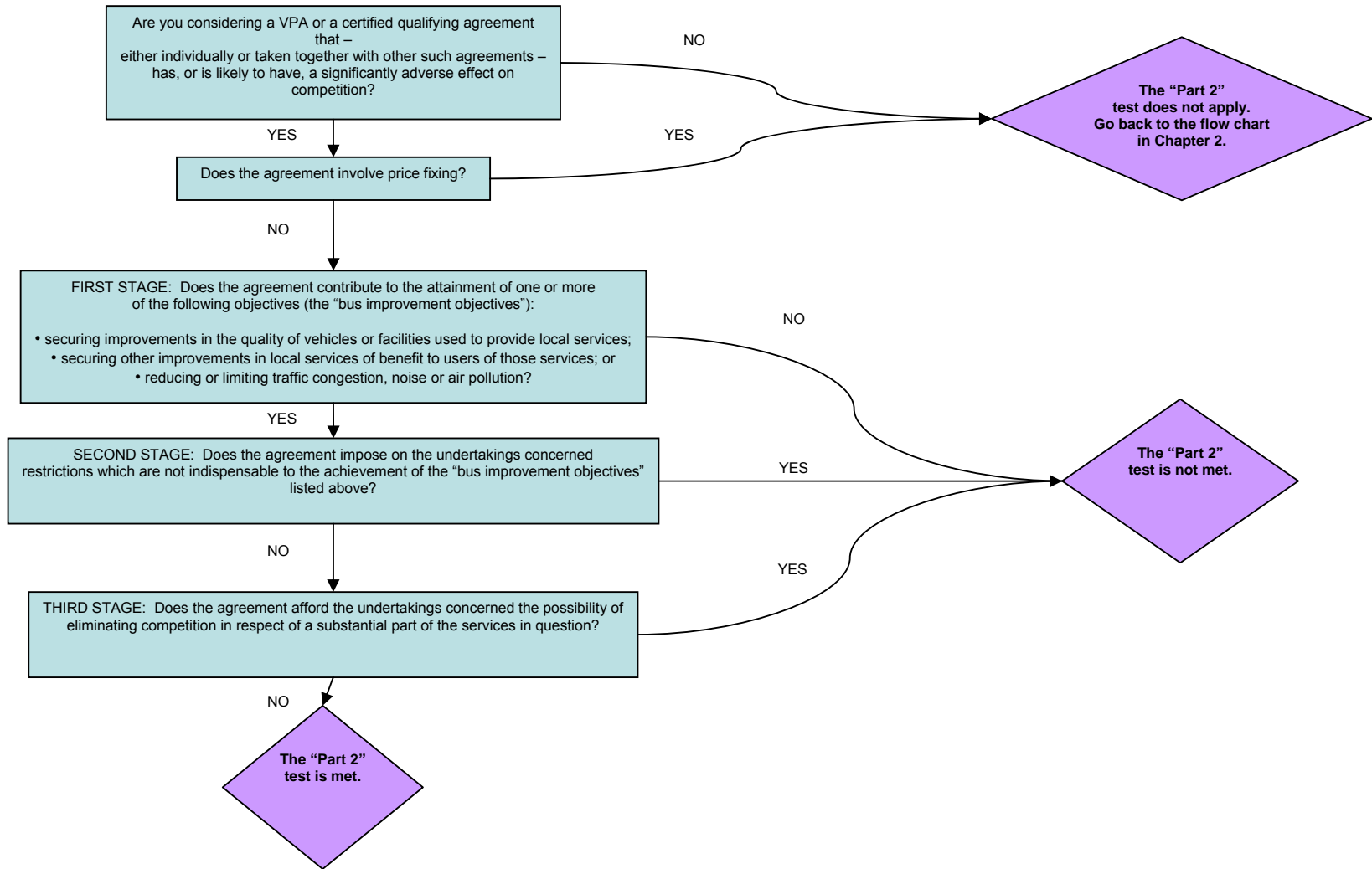
If parties to an agreement to which the Part 2 test applies consider that there may be an effect on trade between Member States, they will need to consider if this effect is appreciable. In making this assessment, consideration should be given as to whether the scheme raises a barrier to entry which has the effect of preventing an operator based in another EC Member State from entering the relevant market in the UK. An agreement which is limited in its application to only one or two local markets in the UK is less likely to affect trade between Member States compared to a network of local agreements which may cumulatively have an appreciable effect on trade between Member States. Where an agreement has an appreciable effect on trade between Member States, the agreement will fall within the provisions of Article 81.

Further guidance is provided in the European Commission's Notice entitled *guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty*.⁴⁴

⁴³ Parties to a VBA may not need to consider Article 81 as VBAs will not generally involve agreements between undertakings. The same principle will generally apply in relation to QPSs since local authorities may not be treated as undertakings for these purposes.

⁴⁴ OJ C101, 27.04.2004, p81.

The "Part 2" test



5. NEGOTIATING A QUALITY PARTNERSHIP SCHEME, VPA OR QUALIFYING AGREEMENT

- 5.1 This chapter suggests, for illustrative purposes, a possible method as to how discussions might be structured to minimise the likelihood of an unlawful agreement that could affect competition being inadvertently entered into.
- 5.2 In this regard, competition law needs to be considered not only at the end of the process - when a QPS is being made, or a VPA or qualifying agreement is being formally entered into - but also *during* the discussions and negotiations leading up to that point. As noted in DfT guidance on VPAs and QPSs, it is possible during those discussions and negotiations for two or more operators to reach an "agreement" within the meaning of competition law. An "agreement" does not have to be made in writing: it can be verbal, or even just a "nod and a wink" if the intention is to signify agreement. Such an agreement is only lawful if the relevant competition test is met in relation to that agreement.⁴⁵ An example of an agreement made during the process is given in Summary box 4 below.

Summary box 4: example of an agreement made during discussions leading up to a VPA

A LTA is seeking to broker a VPA involving the two main bus operators, in order to achieve an increase in service frequencies on a particular route. The LTA meets with the bus operators to discuss the potential for a VPA in which the LTA will provide new bus shelters, while the operators between them will ensure that there is no interval of more than 15 minutes between scheduled services.

The LTA prompts a discussion about how the operators might coordinate their timetables in order to achieve the desired frequency of service. Operator A indicates that it would be prepared to run services at xx00 and xx30, if Operator B were to run services at xx15 and xx45. *Operator B says verbally that it would be prepared to go along with that arrangement.* A formal agreement is subsequently drawn up, and then signed by all three.

Although the discussions were brokered by the LTA, the two operators entered into an "agreement between undertakings" for the purposes of competition law during the course of those discussions by making the verbal agreement about the timing of services (noted in italics above). This is a separate agreement from the VPA itself and would come within the definition of a qualifying agreement (see paragraph 17(4) of Schedule 10). Because the agreement could have an appreciable effect on competition, it would normally

⁴⁵ See Summary Box 1. See also the OFT competition law guideline *Agreements and concerted practices* (OFT401).

fall to be considered against the CA98 test. However, provided this verbal agreement is subsequently certified by the LTA as being in the public interest, and that it does not impose restrictions which are not indispensable to the attainment of the bus improvement objectives, it will be subject to the competition test in Part 2 of Schedule 10.

So in this example, there are two quite separate agreements that must meet the Part 2 test: the verbal qualifying agreement and the VPA itself.

- 5.3 While the participants in a QPS or a VPA need to exercise care throughout any discussions or negotiations there are various things they can do to reduce the risk of breaching competition law.
- 5.4 One option is to conduct discussions and negotiations in two stages, as described below. These two stages do not need to be followed in every respect in every case. However, following the two-stage approach described below could help to reduce the risk of a potentially unlawful agreement being inadvertently made between bus operators and a LTA.

Stage 1 – multilateral discussion

- 5.5 At early stages of the process, it may be convenient for the LTA and all interested bus operators to discuss their broad proposals in a single forum.
- 5.6 At this first stage, discussions should be restricted to the broad principles surrounding a proposed QPS or VPA, and the objectives each party is seeking to meet. All parties should avoid any discussion of the specific terms of agreement (for example, on specific levels of fares, frequencies and timings) they might be prepared to sign up to. Such matters should be covered instead in 'stage two' below.
- 5.7 During the course of this first stage of the discussions, it is advisable for the parties involved to ensure that:
- there is an appropriate agenda (and that it is followed)
 - a detailed record of any discussions at the meeting is kept
 - individual terms with (and between) operators are not negotiated at such a meeting
 - the discussion is not operator- or route-specific, but rather involves a general consideration of the purpose and coverage of the QPS or VPA and

- any criteria for parties joining the discussions at this stage are objective, transparent and non-discriminatory.
- 5.8 Operators also should **not** use the forum as a means of exchanging confidential or commercially sensitive information with other operators for purposes likely to be contrary to competition law.⁴⁶ The exchange of information should be directly related, and indispensable, to the effective operation of the QPS, VPA or qualifying agreement.⁴⁷
- 5.9 Following this suggested approach should help to restrict discussions to legitimate issues relevant to the VPA or QPS. It should also help to limit the potential for discussions between operators that could lead to an agreement or understanding outside of the VPA or QPS that could be contrary to competition law.

Stage 2: Discussing or negotiating terms and conditions on a bilateral basis

- 5.10 During the 'second stage', it is advisable for discussions to be held between the LTA and each individual bus operator separately, on a bilateral basis. Where the LTA has received confidential information from one operator, it is important for the LTA to take care not to divulge that confidential information to any other operator.
- 5.11 Although some information can be legitimately exchanged between bus operators with no risk to the competitive process, if negotiations are held on a bilateral basis between the LTA and each individual bus operator, the potential for the exchange of confidential information between bus operators (and the consequent risk of inadvertently breaching competition law) is going to be reduced.

Do maximum fares have an effect on competition?

- 5.12 One purpose of a maximum fare being set as part of a QPS or VPA is to prevent bus operators with market power setting fares at a level that is not related to the costs of the service provision. It is also a means of ensuring that bus operators with market power do not over-recover any increase in costs that they have incurred as a result of quality improvements secured under a QPS or a VPA. A maximum fare sets the level which fares must not exceed. Individual fare levels remain a matter for the independent commercial judgement of the bus operator. Bus operators continue to compete on fares below and to the level of the maximum fare.

⁴⁶ See OFT competition law guidelines, in particular, *Agreements and concerted practices* (OFT401) and *Trade Associations, professions and self-regulating bodies* (OFT408).

⁴⁷ See OFT competition law guideline *Trade associations, professions and self-regulating bodies* (OFT408), paragraphs 3.4 to 3.16.

- 5.13 There will often be a tendency for fares to gravitate towards the maximum fare which has been set, particularly if competition in the market is weak. However, circumstances of weak competition are also the situation in which it is most likely to be appropriate to impose maximum fares. It follows that LTAs will want to ensure the maximum fare is necessary (for example, where there is weak competition in the market) and when considering what an appropriate level for a maximum fare might be, set the fare at a level that is both cost-related and reasonable.⁴⁸ This relates to the setting of a maximum fare and also to a review or revision of the maximum fare.
- 5.14 When they enter into an agreement with the LTA that provides for a maximum fare to be set, bus operators must ensure that they do not enter into an agreement *with each other* which restricts their freedom to decide the fare to be charged for the services they provide to passengers, for instance by setting fare levels or the actual fare that will be charged. This will ensure that they are not entering into a price-fixing agreement. Paragraph 19(1) of Schedule 10 specifically provides that any VPA or qualifying agreement which constitutes a price-fixing agreement (within the meaning given by section 39(9) of the CA98) is excluded from Part 2 of that Schedule. Any such price-fixing would therefore be treated as a breach of the CA98 and undertakings could be liable to the imposition of financial penalties.

Co-ordinating role of the LTA

- 5.15 LTAs and bus operators will need to be able to exchange some information in order to facilitate both VPA and QPS arrangements on timings and frequencies. Aside from the practicalities of agreeing appropriate terms, operators are unlikely to agree to run services at particular times without knowing what services other operators are agreeing to provide.
- 5.16 When concluding a VPA, there are two approaches that a LTA might wish to adopt in relation to frequencies and timings. Suppose for example that the LTA wishes to secure a minimum of four services per hour on a particular route, with no more than 15 minutes between scheduled services. The options for the LTA are:
- (i) to engage bilaterally with individual operators to identify the contribution they might each be prepared to make to a multilateral agreement aimed at securing the desired minimum frequencies.

⁴⁸ Setting an appropriate maximum fare can be complex. LTAs may wish to engage specialist technical help before deciding on whether to impose maximum fares and their level.

For example, operator A might indicate to the LTA that it would be prepared to run half-hourly services if another operator were prepared to do the same. The LTA could then draw up a single VPA, specifying (say) that operator A would run services at xx00 and xx30, while operator B would run services at xx15 and xx45 or

(ii) for the VPA to specify four services per hour with a maximum interval of 15 minutes, leaving it to the operators to enter into a separate qualifying agreement as to how they will divide the services between themselves. Any such agreement would need to be certified and endorsed by the LTA (otherwise the CA98 would apply instead) and would have to meet the Part 2 competition test.

- 5.17 The two approaches should lead to broadly the same outcome. Option (i) may be simpler because everything is encapsulated in a single agreement, and compliance with the Part 2 competition test needs to be considered only once. But option (ii), the LTA certified qualifying agreement between operators, may offer greater flexibility, as the bus operators can renegotiate the 'timing' aspects of the agreement without needing to re-open the other provisions in the VPA (for example, any facilities being provided by the LTA).
- 5.18 In the case of a QPS covering frequencies or timings, the LTA will most likely need to use some of the same elements as in (i) and (ii) above. In the first instance, it will probably wish to discuss bilaterally with operators the kind of frequency and timing arrangements they might be willing to sign up to. But the QPS itself cannot specify which services will be operated by which operators, so this issue would have to be left to a separate 'qualifying agreement' along the lines of (ii) above. The LTA's exercise of the function of making the QPS would need to meet the Part 1 test; the 'qualifying agreement' would need to be certified by the LTA and meet the Part 2 test.
- 5.19 Whichever approach it took, the LTA would have to ensure that it did not act as a conduit for the exchange of commercial or confidential business information between operators particularly on routes not covered by the QPS, VPA or qualifying agreement. For example, sharing information about route-specific passenger numbers, revenues, costs, profits, investment plans could diminish competition which would otherwise be present between bus operators. The circulation of purely historic information, however, is unlikely to have a similar appreciable effect on competition.

5.20 The general approach of the OFT to information exchange is set out in more detail in the OFT competition law guideline *Trade associations, professions and self-regulating bodies* (OFT408).

Stage 3: the agreement or scheme

5.21 The final stage of the process will depend on whether the parties are working towards a VPA or a QPS. A VPA may well culminate in the signing of a legally binding contract, although other forms of agreement are also possible (see DfT guidance on VPAs).

5.22 A QPS, by contrast, is not an agreement to be signed by each of the parties: rather it is a scheme that is "made" by the LTA, following a formal consultation process. Once the scheme is "made", it is for each individual bus operator to decide whether they wish to take advantage of the facilities specified in the scheme. If they do, they must provide a written undertaking to the traffic commissioner, confirming that they will provide services to the specified standard when making use of the facilities provided by the scheme. The traffic commissioner has power to take enforcement action against anyone who operates a service in contravention of such an undertaking.

6. INVESTIGATIONS BY THE OFT

- 6.1 It is open to any affected person (for example, a passenger or an operator) to complain to the OFT. The OFT has discretion to investigate whether a QPS complies with the Part 1 test or whether a VPA or certified qualifying agreement complies with the Part 2 test. The OFT can commence an investigation either on its own initiative or in response to a complaint. The OFT's decision whether to investigate will depend on the OFT's assessment of its administrative priorities. Schedule 10 to the TA2000 contains two competition tests, each with associated powers of investigation for the OFT.
- 6.2 The OFT's powers of investigation in respect of the Part 1 test remain unchanged by the Local Transport Act 2008 and are still to be found in the TA2000. Its powers of investigation in respect of the Part 2 test are the same as under the CA98. The difference in approach reflects the fact that the Part 1 test relates to the exercise of certain functions by a LTA, whereas the Part 2 test is concerned with agreements to which commercial bus operators are party. The provision which previously enabled LTAs and operators to apply to the OFT for a decision as to whether the exercise or proposed exercise of a function under Part 1 of Schedule 10 meets the competition test has been repealed.
- 6.3 A brief overview of the OFT's powers of investigation is set out below.

Quality partnership schemes

- 6.4 Where the OFT commences an investigation as to whether a QPS complies with the Part 1 test, the OFT may require any person to produce any documents or information that it considers may be relevant to an investigation.

Voluntary partnership agreements and qualifying agreements

- 6.5 As stated above, the OFT can commence an investigation as to whether a VPA or qualifying agreement complies with the Part 2 test either on its own initiative or in response to a complaint. The OFT's decision as to whether to investigate will depend on the OFT's assessment of its administrative priorities.⁴⁹
- 6.6 If the OFT has reasonable grounds to suspect that an agreement falling within the scope of Part 2 of Schedule 10 does not meet the competition test in that Part of the Schedule, then the OFT can use its formal

⁴⁹ Further details about the principles the OFT uses to make prioritisation decisions can be found in *OFT Prioritisation Principles* (OFT953).

powers of investigation as provided for under the provisions of the CA98.

- 6.7 The OFT may also obtain information about undertakings, agreements, practices and markets through informal enquiries. Such enquiries, which may be made at a meeting, in written correspondence or in a telephone conversation, may be made in addition to, or instead of, using the OFT's formal powers. If the OFT is not using its formal powers of investigation, it cannot compel an undertaking to respond to an informal enquiry. Undertakings are nevertheless encouraged to co-operate with all OFT enquiries and investigations.
- 6.8 The OFT's formal powers of investigation are set out below. A more detailed description of the OFT's powers of investigation can be found in the OFT's competition law guideline on powers of investigation.⁵⁰

Production of specified documents and information

- Where the OFT has reasonable grounds for suspecting that an agreement falling within the scope of Part 2 of Schedule 10 does not meet the competition test, it can require a person to produce specified documents or to provide specified information.⁵¹

Powers to enter business premises without a warrant

- If the OFT has reasonable grounds for suspecting that an agreement falling within the scope of Part 2 of Schedule 10 does not meet the competition test, it has the power to enter business premises to carry out inspections without a warrant. Advance written notice must be given to the occupier of the premises. These powers enable the OFT to enter premises and to gain access to documents relevant to an investigation.⁵²

Powers to enter and search any premises with a warrant

- An application can be made to the High Court for a warrant for a named officer of the OFT and other authorised officers to enter and search both business and domestic premises (the latter may not be entered without a warrant).⁵³

⁵⁰ OFT competition law guideline *Powers of investigation (OFT404)*.

⁵¹ Paragraph 23 of Schedule 10 to the TA2000, applying section 26 of the CA98.

⁵² Paragraph 23 of Schedule 10 to the TA2000 applying section 27 of the CA98.

⁵³ Paragraph 23 of Schedule 10 to the TA2000 applying section 28 of the CA98. This provides that a named officer is also an authorised officer. A named officer is the principal officer of the OFT in charge of executing the warrant.

Offences relating to the powers of investigation

6.9 There are a number of criminal offences which may be committed where a person fails to co-operate when the powers of investigation set out above are exercised.⁵⁴ It is an offence for a person to:

- fail to comply with a requirement imposed under the powers of investigation
- intentionally obstruct an authorised officer carrying out an inspection either with or without a warrant
- intentionally or recklessly destroy or otherwise dispose of or falsify or conceal a document that they have been required to produce or cause or permit its destruction, disposal or falsification or concealment, or
- provide information that is false or misleading in a material particular if they know, or are reckless as to whether, it is false or misleading, either to the OFT or to another person such as an employee or legal adviser, knowing that it will be used for the purpose of providing information to the OFT.

6.10 The sanctions which may be imposed by the courts on a person found guilty of one of these offences include an unlimited fine and/or up to two years imprisonment. More details are set out in the OFT competition law guideline '*Powers of Investigation*' (OFT404).

⁵⁴ Paragraph 23 of Schedule 10 to the TA2000 applying sections 42-44 of the CA98.

7. INFORMATION

- 7.1 There are limits on the disclosure of information that has been obtained by the OFT in connection with its functions under the TA2000, and which relates to the affairs of an individual or any particular business. This information must not be disclosed during the lifetime of the individual, or while the business continues, unless consent to disclosure has been given by the person from whom the information was obtained or, if different, the person to whose affairs the information relates, or the person carrying on the business. There are, however, certain gateways which provide that such information may be disclosed in certain specified situations. This includes where disclosure is made for the purpose of facilitating the performance of any functions of the OFT or a traffic commissioner.
- 7.2 An offence may be committed if such information obtained by the OFT is disclosed other than in specified circumstances.
- 7.3 In relation to the provision of information, a criminal offence may be committed by:
- knowingly or recklessly providing false or misleading information to the OFT in connection with its functions under the TA2000, or
 - knowingly or recklessly providing false or misleading information to another person, knowing that the information is to be used for the purpose of providing information to the OFT in connection with its functions under the TA2000.

8. DECISIONS AND THE OFT'S POWERS OF ENFORCEMENT

- 8.1 As noted earlier, Schedule 10 to the TA2000 contains two competition tests. The OFT has different enforcement powers depending on whether the party under investigation is subject to and has failed to satisfy the Part 1 test (for a QPS, ticketing schemes or inviting and accepting tenders under the Transport Act 1985) or the Part 2 test (for a VPA or LTA certified qualifying agreement).
- 8.2 The OFT's powers of enforcement in respect of the Part 1 test are set out in Schedule 10 to the TA2000 (see paragraph 12 of Schedule 10). Its powers of enforcement in respect of the Part 2 test are largely the same as under the CA98 (as applied by paragraph 23 of Schedule 10). However, the OFT's powers to impose financial penalties for breaches of the Chapter I prohibition do not apply to VPAs and qualifying agreements to which the prohibition in paragraph 20 of Schedule 10 to the TA2000 applies (i.e. exempt agreements). The exception to this is where a VPA or qualifying agreement is a price fixing agreement or is in breach of Article 81 of the EC Treaty. If this is the case, then the OFT does have the ability to impose financial penalties.

Decisions

Quality partnership schemes

- 8.3 Where the OFT makes a decision in relation to the Part 1 test after an investigation, it must publish the decision, together with its reasons for making the decision.
- 8.4 If the OFT decides as a result of an investigation that a scheme does not meet the Part 1 test, it may give to the LTA or LTAs making or varying the scheme such directions as it considers appropriate. These may include:
- where a QPS or ticketing scheme has been proposed, a direction prohibiting the scheme in the form proposed
 - where a QPS or a ticketing scheme has been made or varied, a direction requiring that it should be revoked or varied
 - where an invitation to tender under section 89 or 91 of the Transport Act 1985 has been issued, a direction requiring the variation or withdrawal of the invitation, and
 - where a tender under section 89 or 91 of the Transport Act 1985 is accepted or not accepted, a direction requiring the variation or

termination of any agreement entered into by accepting the tender or requiring the acceptance of the tender.

- 8.5 The OFT may apply to the High Court in England and Wales for an order requiring the LTA to comply with the direction within a specified time if it has failed to do so without a reasonable excuse.
- 8.6 There are no specific provisions for appeals against the OFT's decision under TA2000. Decisions made by the OFT are subject to judicial review.

Voluntary partnership agreements and qualifying agreements falling within Part 2 of Schedule 10

- 8.7 Where the OFT makes a decision in relation to the Part 2 test after an investigation, it must publish the decision, together with its reasons for making the decision. If the OFT decides as a result of an investigation that an agreement does not meet the Part 2 test, it may:
- give directions to bring an infringement to an end
 - accept binding commitments offered to it.
- 8.8 The OFT also has powers to give interim measures directions during an investigation pending a final decision.
- 8.9 The OFT's powers to impose financial penalties under the CA98 do not apply to agreements which fail to be considered under the Part 2 test but which fail to meet that test, provided the arrangement does not involve price fixing and is not in breach of Article 81 of the EC Treaty.
- 8.10 Where an agreement falls to be considered under the Part 2 competition test but fails to meet that test it is prohibited. This means it is void and unenforceable.
- 8.11 An appeal against a decision of the OFT in relation to an agreement to which the Part 2 competition test applied can be made to the Competition Appeal Tribunal (CAT). Such an appeal must be brought within a period specified in the CAT Rules, currently two months from the earlier of the date upon which the company which is bringing the appeal was notified of the decision and the date of the publication of the decision.

9. APPLICATION OF THE PART 1 TEST TO TICKETING SCHEMES

- 9.1 This section sets out the possible competition concerns that might arise with ticketing schemes made under section 135 of the TA2000. Functions of the LTA in making or varying a ticketing scheme will need to satisfy the Part 1 test of the TA2000.
- 9.2 Ticketing schemes made under the TA2000 may include the following types of tickets:⁵⁵
- multi-operator travelcards
 - through tickets
 - multi-operator individual tickets, and
 - short or long distance add-ons.
- 9.3 Public transport ticketing schemes may prevent, restrict or distort competition to an appreciable extent. The competition concerns that are likely to arise as a result of ticketing schemes are discussed in the OFT's competition law guideline *Public transport ticketing schemes block exemption*.⁵⁶
- 9.4 Because integrated public transport ticketing schemes can also be beneficial for consumers, the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) Order 2000 (SI 2001 No 319)⁵⁷ (the block exemption) exempts certain categories of integrated ticketing schemes from the Chapter I prohibition, subject to certain conditions in the block exemption being satisfied.
- 9.5 Where a ticketing scheme is made under section 135 of the TA2000 the Part 1 test in Schedule 10 will apply. Where the Part 1 test is satisfied the block exemption is also likely to be met.

Possible effects of ticketing schemes

- 9.6 The first step in assessing whether a ticketing scheme passes the Part 1 test is to consider whether the ticketing scheme has, or is likely to have, a significantly adverse effect on competition.
- 9.7 In assessing whether a ticketing scheme has a significantly adverse effect on competition, the parties to the scheme should follow an

⁵⁵ These types of tickets are described in more detail in paragraph 2.8 and in the OFT's competition law guideline *Public transport ticketing schemes block exemption* (OFT439).

⁵⁶ OFT competition law guideline *Public transport ticketing schemes block exemption* (OFT439).

⁵⁷ As amended by the Competition Act 1998 (Public Transport Ticketing Schemes Block Exemption) (Amendment) Order 2005 (SI 2005/3347).

approach which is consistent with that taken in the block exemption.⁵⁸ Ticketing schemes could, in particular, have a significantly adverse effect on competition if they:

- prevent any operator (existing or potential) from taking part in the scheme, without any 'objective, transparent and non-discriminatory' reasons
- limit the variety or number of routes, or the price or availability of any single operator tickets offered by individual operators
- limit the frequency or timing of any public transport services operated by individual operators, except where doing so is indispensable to providing effective onward travel connections for passengers
- facilitate an exchange of commercially sensitive information between operators, except where the exchange of information is directly related, and indispensable, to the effective operation of the scheme, and the provision requiring the exchange of information is 'objective, transparent and non-discriminatory',⁵⁹ or
- eliminate individual operator single tickets as these can provide a competitive discipline on ticketing scheme prices.

Application of the Part 1 competition test to ticketing schemes

- 9.8 Where a ticketing scheme has or is likely to have a significantly adverse effect on competition it is necessary for the LTA to consider whether it satisfies one or more of the objectives in the Part 1 competition test described in paragraph 3.10 above.
- 9.9 Ticketing schemes which meet only the first and/or second of the purposes (improvements in the quality of vehicles/facilities or improvements in local services of substantial benefit to users of local services) will be assessed first by balancing the benefits to consumers against the detriments to competition, and secondly by assessing whether the scheme is reasonably necessary to achieve the purpose. A

⁵⁸ Under the TA2000, a ticketing scheme may require operators to enter into certain ticketing arrangements. It should be noted that those ticketing arrangements which fall within the block exemption are called 'public transport ticketing schemes' in the block exemption.

⁵⁹ For large scale and profitable multi-operator travelcard schemes in metropolitan areas parties are likely to have to exchange information only on a strictly confidential, bilateral basis through an impartial person (an 'information referee'). A less stringent approach is likely to be suitable for small-scale schemes where the revenue or potential revenue does not allow for the appointment of an information referee. For multi-operator individual tickets it is likely that little or no information will need to be exchanged.

ticketing scheme which meets the third purpose (reducing or limiting traffic congestion, noise or air pollution) will be assessed on the basis of whether it has the least adverse effect on competition reasonably necessary to achieve the purpose.

- 9.10 In considering whether a ticketing scheme has the least adverse effect on competition, the parties to the scheme should again follow an approach which is consistent with that taken in relation to the block exemption. For example, the TA2000 does not give LTAs the power to set the prices in a ticketing scheme⁶⁰ and generally fixing the price of tickets is prohibited by the CA98. The block exemption does, however, permit operators to agree the price of a multi-operator travelcard.⁶¹
- 9.11 In terms of through tickets and add-ons, the OFT would recommend that operators set prices using a 'posted prices'⁶² mechanism. This method of setting prices is generally considered to have the least adverse effect on competition. In the case of multi-operator individual tickets, the preferred method is for 'revenue to lie where it falls'.⁶³
- 9.12 An example of how the Part 1 test may be applied to a ticketing scheme implemented under section 135 of the TA2000 is set out below.

Scenario

- 9.13 Operators A and B provide local bus services and operate in competition along the same route between Uptown and Downtown. The LTA wishes to introduce a ticketing scheme comprising of a multi-operator individual ticket (MIT),⁶⁴ so that passengers can purchase one ticket which entitles them to use either operator A or B's services on the route between Uptown and Downtown.
- 9.14 Each operator is concerned that the other operator will obtain greater revenue from the ticketing scheme if revenue lies where it falls and therefore revenue from the MIT is shared on the basis of passenger journeys.⁶⁵ The price of the MIT is independently set by each operator.

⁶⁰ A VPA or QPS which includes an agreement on maximum fares may be permissible and this is discussed in chapters 3 and 4 of this Guidance.

⁶¹ An explanation of why fixing the price of multi-operator travelcards is permissible is discussed in the OFT competition law guideline Public transport ticketing schemes block exemption (OFT439).

⁶² This is the reimbursement that an operator independently decides it requires for any passenger that it carries who uses a ticket purchased from another operator.

⁶³ This means that the operator that collects the money keeps it.

⁶⁴ See paragraph 2.8 for a description of this type of ticket.

⁶⁵ This approach would divide total revenue according to how many journeys are undertaken on each operator's service, with no account taken of the length of the journey or the mode of transport.

Applying the Part 1 test

Stage 1: is there a significantly adverse effect on competition?

9.15 In this example, a MIT may result in the elimination of operators' own single and return tickets and therefore may have a significantly adverse effect on competition. Because there is a significantly adverse effect on competition, stages 2 to 3 will need to be satisfied.

Stage 2: is the purpose of the scheme one of the three purposes identified in the Part 1 competition test?

9.16 The three purposes are the same as described at paragraph 3.10 and are as follows:

- secures improvements in the quality of vehicles or facilities used for or in connection with the provision of local services
- secures other improvements in local services of benefit to users of local services
- reduces or limits traffic congestion, noise or air pollution.

9.17 In this case, it is likely that the MIT satisfies the second purpose in that it secures improvements in local services of substantial benefit to users of local services. This is because the MIT will benefit passengers in that they can buy one ticket which entitles them to use either operator A or B's services between Uptown and Downtown. Therefore, passengers have more flexibility of choice.

Stage 3: is the adverse effect on competition proportionate to the purpose being sought to be achieved?

9.18 It is necessary to consider whether the adverse effect on competition is proportionate to the achievement of the purpose. This is a two stage process. First, the benefits resulting from the ticketing scheme are balanced against the detriment to competition. In this example, the benefits to passengers arising from the MIT are likely to outweigh the detriment to competition if the benefits to passengers in the form of flexibility of choice are greater than the detriment to competition in the form of the elimination of operators' own single or return tickets.

Is the scheme necessary to achieve the purpose(s)?

9.19 The parties to the scheme must consider whether the ticketing scheme is necessary to achieve the purpose(s) set out in paragraph 9.16 above. Provided that the revenue distribution method is limited to what is necessary for the MIT scheme to work then it is likely that the adverse

effect on competition arising from the ticketing scheme will be proportionate. For example, a MIT which distributes revenue on the basis of passenger journeys is likely to satisfy these two conditions. The MIT in the scenario will therefore satisfy the Part 1 competition test.

10. TENDERS UNDER THE TRANSPORT ACT 1985

10.1 This chapter sets out the possible competition concerns that might arise with tenders made under the Transport Act 1985 as well as how the Part 1 test will apply to such tenders.

Legal requirements for tendering procedures

10.2 The agreements to which these provisions apply are between a LTA and a bus operator whereby the LTA subsidises the operator to provide a local service which would not, but for that subsidy, be provided.⁶⁶ Subject to certain exceptions,⁶⁷ section 89 of the Transport Act 1985 provides that such agreements can only be entered into following a competitive tendering procedure.⁶⁸

Possible effects of tenders

10.3 Tenders for subsidised services may foreclose the market from new entry. This can occur either where the duration of the service being tendered is unreasonably long, or where tenders for more than one service are unnecessarily 'bundled' together.⁶⁹

10.4 Where a service may be economically viable only with a subsidy from a LTA, competition is likely to exist only for the tender (and not between operators of commercial services on the road). The longer the duration of the service being tendered, by definition, the longer the market is likely to be foreclosed to competition, as there will be no competition for the duration of the tender.⁷⁰ A tender granted for a longer period is more likely to have a significantly adverse effect on competition (as the advantages of competition for the market are realised less frequently). Correspondingly, it is more likely that such a tender will have to fulfil one or more of the justifications, and be proportionate.⁷¹ While the circumstances of each case will differ, the OFT considers that, in general, a tender for longer than five years would be more likely to have a significantly adverse effect on competition than a tender of shorter

⁶⁶ See section 63(5) of the Transport Act 1985.

⁶⁷ Section 91 of the Transport Act 1985 sets out the exceptions when section 89 will not apply.

⁶⁸ Section 90 of the Transport Act 1985 sets out additional obligations on LTAs when entering into agreements for local services.

⁶⁹ See the European Commission's Notice Guidelines on Vertical Restraints, Commission Notice 2000/C 291/01 (OJ C291, 13.10.2000, p1).

⁷⁰ The effect of section 70 of the Local Transport Act 2008 is to extend the maximum length of subsidised services agreements from five to eight years. The maximum permitted under European legislation is ten years (see the Regulation of the European Parliament and of the Council on public passenger transport services by rail and by road and repealing Council Regulations (EEC) Nos. 1191/69 and 1107/70 - Regulation (EC) No. 1370/2007 of the European Parliament and of the Council dated 23 October 2007 (O.J. L 315/ 1; 3.12.2007).

⁷¹ See paragraph 10.7.

duration. The maximum permitted length of such agreements under the Transport Act 1985 is eight years.⁷²

- 10.5 Bundling blocks of routes together for one bid (or operators block bidding for tenders) can have the effect of excluding from the market smaller operators who would be unable to operate large numbers of services, although they would have been able to tender for a small number of services. Tendered services provide an important method of entry into the bus market for new and small operators. If that entry opportunity is denied to them, competition for tenders may ultimately be reduced. This is likely to be a greater problem if there is a larger number of services that are bundled, as this reduces the number of non-bundled services available to tender. Concerns may also be raised where part of the tender requires the purchase of buses specifically suited to the terms of the tender (for example low or flat-floor buses), which may then provide the successful operator with an advantage when the route is re-tendered.
- 10.6 The Part 1 test recognises, however, that even if a tender contract has a significantly adverse effect on competition, this may be justified if the tender contract produces certain benefits, and is 'proportionate'.

Application of the Part 1 test to tenders

- 10.7 The exercise of a function to invite and accept tenders to provide a service or services which has or is likely to have a significantly adverse effect on competition is most likely to be justified if it achieves the first (improvements in the quality of vehicles or facilities) and/or the second purpose(s) (other improvements in local services of benefit to users of local services). The proportionality test will therefore combine a balancing exercise with an assessment of whether or not the restrictions are a necessary means of achieving the relevant benefits.
- 10.8 Where a tender does not require capital expenditure by the operator on dedicated new assets, the duration of the service tendered should be such that it does not constitute a significant barrier to entry by foreclosing the market for an unreasonable length of time. While each case has to be considered on its own individual merits, as a general rule of thumb, a tender for an agreement with duration in excess of five years is more likely to create a barrier to entry than a shorter term tender contract. A tender offered for a longer period of time could, however, be justified if it met one or more of the purposes, and was proportionate. Where the tender requires capital expenditure on assets that could not easily be used elsewhere, LTAs may consider that the

⁷² See section 90(1) of the Transport Act 1985 as amended by section 70 of the Local Transport Act 2008.

duration of the tender should be for the minimum period necessary to enable the net cost of the capital investment to be recovered.⁷³

- 10.9 Where bundling of tenders has or is likely to have a significantly adverse effect on competition, it will have to be justified on the grounds that it fulfils one or more of the purposes, and is proportionate to the significantly adverse effect on competition caused. For example, cost savings achieved by bundling services might be used to meet one or more of the purposes in order to pass the test.
- 10.10 A proposal by an LTA to tender for additional services on a route where a commercial service is already operated may raise concerns from the operator of the existing service. The existing operator may not be able to compete with a service which is subsidised by an LTA and may be forced to leave the market. In general, this is less likely to have a significantly adverse effect on competition where the criteria for the tender are open, clear and transparent. The important thing here is that all operators, including the existing commercial operator, can compete for the tender. It would be difficult for a tender to pass the second and third elements of the Part 1 test if it resulted in fewer services being available to bus passengers.

⁷³ This approach was used by the European Court of First Instance in Case T374/94 *European Night Services v Commission* [1998] ECR II-3141. See also the European Commission's Notice *Guidelines on Vertical Restraints*, Commission Notice 2000/C 291/01 (OJ C291, 13.10.2000, p1).

Annexes:

A THE SCENARIO

Scenario

- A.1 Anytown is currently served by six private bus operators. There are two large operators and four smaller operators providing bus services in Anytown.
- A.2 There is no significant history of entry by other firms operating outside Anytown. What competition there is in the market is mainly on a small scale involving individual routes and for services put out to tender by the LTA.
- A.3 As part of the redevelopment of the city centre, a new shopping complex with a large number of high street stores and a supermarket is currently under construction, and will be completed within the year.
- A.4 Increasing congestion has led to a rise in urban air pollution. This has resulted in an increase in the number of cases of breathing related illnesses such as asthma.
- A.5 In some parts of Anytown, bus services are relatively infrequent because passenger demand is spread thinly throughout the day outside peak hours. This has resulted in high waiting times between services for some passengers travelling at certain times of the day. However, a survey by the LTA has established that if frequencies were to be increased more consumers say they would be likely to use bus services in preference to other forms of transport.
- A.6 The local economy has developed a strong service sector in recent years, with significant growth in the number of jobs in the centre of Anytown. The LTA is concerned about the growth in congestion, particularly at peak times, and how this impacts on the productivity of the local economy. The lack of coordination in bus operators' timings is leading to congestion at bus stops and nose-to-tail bus congestion.
- A.7 There are two hospitals in Anytown. Hospital E is situated in the east part of the town. Hospital W is situated in the west part of the town. At present, residents wishing to travel from the east side of the town to Hospital W need to use the services of two different operators. The same applies for residents of the west part of town travelling to Hospital E. The absence of any coordination in the timing of the two services means that passengers have to wait for the connecting bus service, increasing overall journey time.

- A.8 The LTA considers that fare increases by local operators are undermining passenger confidence in local bus services and are unrelated to the costs of the services provided.
- A.9 The LTA would like to improve the delivery and performance of bus services in the local area. Its overall aim is to encourage car users to switch to a public transport alternative, in particular, to increase bus patronage. In summary, the LTA wishes to include specific measures designed to:
- improve the quality of bus services for shoppers
 - increase the number of environmentally friendly buses
 - increase the frequency of services on key routes
 - improve management of peak traffic volume
 - improve coordination of bus services on key corridors supplying the hospitals, and
 - reduce fares.
- A.10 The overall aim of the LTA is to try to boost the local economy and quality of life for those who live, work and holiday in the locality. Each of the issues set out in the bullet points above is considered in more detail below.

The issues which the LTA wishes to address

1) Improve the quality of bus services for shoppers

- A.11 The LTA believes that the operators currently providing bus services in Anytown do not provide enough baggage storage space on their buses for passengers' shopping bags and that shoppers are, therefore, more likely to use other modes of transport to get to and from the new shopping complex. The LTA would prefer shoppers to use buses rather than other forms of transport.

2) Increase the number of environmentally friendly buses

- A.12 The LTA wants operators to invest in green technology, for example, to buses that produce lower emissions. This initiative may be complementary to other LTA initiatives designed to encourage a greener environment and persuade the local populace and holiday makers to use buses and other forms of public transport over the private car.

3) Increase the frequency of services on key routes

A.13 The LTA wants to provide bus passengers with a more frequent service and lower the waiting times for passengers on key routes.

4) Improve management of peak traffic volumes

A.14 The LTA wants to improve management of demand at peak times by encouraging bus operators to space out the timings of their services rather than bunching services to the detriment of the traffic-flow at peak times and to the provision of services at these times.

5) Improve coordination of bus services on key corridors supplying the hospitals

A.15 The LTA wants local operators to introduce a joint service running from east to west on this particular corridor so that passengers travelling to either of the hospitals do not have to wait for the connecting bus service.

6) Ensure fares are related to operators' costs

A.16 The LTA cannot set fare levels for bus operators. It cannot, therefore, directly act to reduce fares. However, it can negotiate and agree a maximum fare with local operators so that fares bear a reasonable relation to the cost of providing the services.

Benefits to bus operators

A.17 The LTA has identified some measures that could be beneficial to bus operators and that might provide them with an incentive to improve the provision of local bus services. In particular, there are a number of pinch-points on key routes where bus priority measures would lead to a substantial increase in efficiency, leading to faster, more reliable journey times and reduced operating costs. The provision of real-time service information at bus stops would also increase the attractiveness of bus services to passengers.⁷⁴

A.18 There is mutual benefit in a package of measures that incorporates the improvements described in paragraph A.9 above, alongside those outlined in paragraph A.17 above. Depending on local circumstances, there could be merit in delivering this package either through a QPS, a VPA or, for particular measures such as agreeing service timings,

⁷⁴ In this scenario the LTA has identified improvements that could be made. However, it is worth noting that bus operators could also suggest ways of improving local services to the LTA. This could also be the trigger for a VPA or a QPS.

qualifying agreements between operators only. Annexes B and C respectively explore the position under a QPS and VPA.

B APPLICATION OF THE PART 1 TEST TO THE QUALITY PARTNERSHIP SCHEME

- B.1 As noted in chapters 1 and 2 of this guidance, the functions of the LTA in making and varying QPSs are subject to the competition test set out in Part 1 of Schedule 10 (the Part 1 competition test) to the TA2000.
- B.2 A bus operator that agrees to provide services to the standard specified in the QPS in order to use the facilities provided by an LTA is not at risk of breaching competition law; but
- where two or more operators enter into a qualifying agreement, defined in Schedule 10, to underpin the delivery of the standards of service in the QPS, provided that agreement has been certified by the LTA as being in the public interest and only containing restrictions which are reasonably necessary to meet the bus improvement objectives, then that agreement will be subject to, and need to satisfy, the Part 2 competition test in Schedule 10 to the TA2000 (the Part 2 competition test); and
 - any agreement (or part of an agreement) between operators which does not have the appropriate certification will be subject to the Chapter I prohibition of the CA98 and will need to satisfy the test in section 9 of that Act.
- B.3 The following section considers the application of the Part 1 competition test to a hypothetical QPS based on the Scenario set out in Annex A. The section also includes some examples of situations where, in the OFT's view, the Part 1 test would not be met, in order better to illustrate how the test is likely to be applied.
- B.4 Annex C considers the application of the Part 2 competition test to a VPA or qualifying agreement.

First stage: is there a significantly adverse effect on competition?

- B.5 The test is whether the making of the QPS by the LTA has, or is likely to have, a significantly adverse effect on competition. It is the overall effect on competition, rather than the effect on a particular competitor or competitors, that is important.
- B.6 For example, it is possible that a QPS may have a significantly adverse effect on a particular competitor, but may not have an adverse effect on competition because other bus operators (either actual or potential, or both) can still exercise an effective competitive constraint in the relevant market. The LTA will, therefore, need to have a reasonable idea of what

the 'relevant market' is and whether any of the undertakings supplying such services (actual or potential) are likely to have any market power in that market. The purpose of the QPS is not considered at this stage.

A practical approach to Stage 1 of the Part 1 competition test

- B.7 It is likely that a QPS involving more than one bus operator that contains restrictions relating to the timing or frequency of services will have a significantly adverse effect on competition.
- B.8 While the OFT will look at each case individually when it applies the Part 1 competition test, it may be a reasonable working assumption on the part of LTAs and bus operators that there will be a significantly adverse effect on competition when assessing whether the Part 1 competition test might apply. In some cases, it may be clear that that the competition test does not apply. However, there may be other cases, for example, where timing restrictions are involved, that these will have a significantly adverse effect on competition and must, therefore, be considered under the second and third stages of the Part 1 competition test.

Second stage: does the QPS contribute to the achievement of one or more of the specified purposes?

- B.9 A QPS which has a significantly adverse effect on competition may be 'justified' if it is set up with a view to achieving one or more of the three purposes specified in paragraph 2(3) of Schedule 10 (and which are described in paragraph 3.10 of Chapter 3). As explained in Chapter 3, the relevant purposes are that the QPS:
- secures improvements in the quality of vehicles or facilities used for or in connection with the provision of local services
 - secures other improvements in local services of benefit to users of local services, or
 - reduces or limits traffic congestion, noise or air pollution.
- B.10 If the making or varying of a QPS contributes to one or more of these purposes, the second stage is met and the third stage must then be considered. This assessment of the second stage requires a simple 'yes' or 'no' consideration. It should, therefore, be fairly clear whether this stage of the test has been met.

Third stage: is the adverse effect on competition proportionate to the purpose being sought to be achieved?

- B.11 This requires an assessment of whether the QPS imposes restrictions that are proportionate to the attainment of the specified purposes under the second stage of the Part 1 competition test. In practical terms, the individual restrictions of competition that flow from the agreement must be reasonably necessary for the attainment of the specified purposes.
- B.12 The underlying purpose of the QPS in the scenario set out in Annex A is to improve the quality of the existing services. The LTA has, in this case, identified that, in its view, some restriction of competition is necessary to improve the quality of existing services and therefore deliver certain benefits to consumers.
- B.13 The LTA has to consider whether the fact that the significantly adverse effect on competition outweighs the potential benefits. In practical terms, this requires a consideration of what the possible alternative ways of securing the benefit might be and whether those alternative methods might secure the same benefit in a way that is less restrictive of competition. In general, if the restrictions are reasonably necessary in order to secure the benefit then the third stage of the assessment is likely to be satisfied. The parties to the QPS will generally be well placed to make such an assessment and to analyse the effect of the QPS because of their knowledge and understanding of the prevailing market conditions in their particular locality.
- B.14 It is worth noting here, for the sake of completeness, that the provisions in the TA2000 as amended by the Local Transport Act 2008 enable a LTA to specify “registration restrictions” in a QPS. These are restrictions which the LTA considers are necessary or expedient to impose so as to prevent the introduction of new services (or the withdrawal or variation of existing ones) which might be detrimental to the provision of services under the scheme.⁷⁵ Where a scheme includes such restrictions, it must also specify the registration criteria which the traffic commissioners will use, together with representations received from relevant operators or local authorities, to decide whether to accept an application for registration (or to vary or cancel an existing registration) to which such restrictions apply. Where such restrictions are included in a QPS, the Part 1 competition test will need to be satisfied in relation to those restrictions.
- B.15 The following section sets out each individual element of the hypothetical QPS applicable to the scenario set out in Annexe A and considers whether it satisfies the second and third stages of the Part 1 competition

⁷⁵ Section 114(3B) of the TA2000 as inserted by section 13(4) of the Local Transport Act 2008.

test (we assume for the purposes of illustrating the application of the Part 1 competition test that the first stage is passed i.e. that there is a significantly adverse effect on competition in most of the following examples and that it is, therefore, necessary to apply the second and third stages of the Part 1 competition test).

Improve the quality of bus services for shoppers

Second stage

- B.16 The aim of this element of the QPS is to improve the existing quality of buses, particularly in relation to those services on routes going to the new shopping complex. Specifically, the bus storage space needs to be bigger (to provide more space for passengers' bags) than is currently provided for in the vehicles being used by local bus operators.
- B.17 This will achieve the first and second of the three specified purposes (and possibly the third as well if more shoppers chose to travel by bus). The second stage of the test is, therefore, satisfied.

Third stage

- B.18 The possible adverse effect on competition in this case would be in terms of raising 'barriers to entry' by raising the cost to actual or potential bus operators using the QPS facilities on the routes serving the new shopping complex.
- B.19 For example, if the costs and difficulty of improving the buses were considerable then the 'barriers to entry' are likely to be high, and the adverse effect on competition greater than might otherwise be the case. However, the measures may nevertheless still be proportionate – and the Part 1 competition test satisfied – if the benefits are shown to be high and the restrictions reasonably necessary to achieve the benefits.
- B.20 In this case, if the costs of providing additional storage space are modest but the benefit to passengers is significant, the third stage is likely to be met.

Non-compliant

- B.21 If the QPS were to require buses on *all routes* to be bigger and have more shopping space, rather than just those serving the shopping complex route, the requirement would be likely to fail the third stage of the test, at least in so far as it affected other routes not serving the new shopping complex. This is because there is no particular benefit to having

greater capacity to carry more bags on routes which do not require it, and therefore the second and third stage of the test would not be satisfied.

Increase the number of environmentally friendly buses

Second stage

- B.22 The objective of this part of the QPS is to encourage bus operators to use buses that produce lower emissions. This will help to reduce pollution and improve air quality. The second stage of the Part 2 test is, therefore, satisfied.

Third stage

- B.23 The possible adverse effect on competition in this case would also be increasing 'barriers to entry' by raising the cost to actual or potential bus operators using the facilities provided by the QPS.
- B.24 The QPS requires bus operators wishing to use the facilities provided by the QPS to agree to phase in more environmentally friendly buses over an agreed period of time. If the cost of adapting buses is low, then the overall reduction in competition is likely to be small and the benefits to consumers likely to outweigh the reduction in competition resulting from the restriction (and vice versa, for example, if costs are high then the benefit to consumers may not outweigh the adverse effect on competition – see non-compliant example below).
- B.25 In this instance, we have assumed that without the QPS the phasing in of more environmentally friendly vehicles may have been significantly longer and less consistent and that the restriction of competition is therefore reasonably necessary to deliver the benefits of reduced pollution to the wider public.⁷⁶

Non-compliant

- B.26 If the QPS required certain types of buses or only new buses to be operated on the route, but this was unnecessary to achieve the environmental goal of lower emissions and reduced pollution, then the requirement would fail the third stage of the test. If such measures would provide some small further environmental benefits, it would be a matter of weighing up whether the increased costs, and resulting barriers to entry, could be justified with regard to the small additional benefits to be realised.

⁷⁶ Note that the benefit claimed is to the wider public and not just to bus passengers.

Increase the frequency of services on key routes

Second stage

- B.27 The aim of this part of the QPS is to increase the frequency of services on key routes from three services an hour to six. Increasing the number of services on this key route is a substantial benefit to users of local services.
- B.28 It is only likely to help reduce congestion or air pollution if it is accompanied by some modal shift from private cars to buses. Because it is of benefit to users of local services the second stage of the test is satisfied.

Third stage

- B.29 The restriction is the requirement to provide a particular minimum frequency of service. The LTA considers that the restrictions are reasonably necessary in order to achieve the objective of the QPS.⁷⁷
- B.30 The objective of the agreement is to increase frequencies to six per hour (from three), so as to ensure there are sufficient services operating on the routes in question. The LTA considers that the benefits outweigh the potential detriment to competition because the restriction benefits the users of local services, through reduced waiting times. A more frequent service is likely to be more attractive to people who did not previously use the bus, thereby encouraging greater bus patronage (which in turn helps to reduce road congestion by attracting passengers who may previously have opted to use their car instead).

Non-compliant

- B.31 The detriment in this case could possibly be that the increased frequency of services has really been introduced with a view to reducing the potential for new entry on the route (as it requires a certain minimum scale of entry). This would be more obviously the case if we assume that the LTA is aiming to double the frequency of services where buses already run every five minutes, are always half-empty and where buses are already a substantial contributor to traffic congestion. In this instance, benefits would not be similarly present because the reduction in average waiting times is small, there is no meaningful reduction in car traffic and the extra buses on the road could mean that bus journeys take longer than before. If this was correct, then the intended purpose would not fall within those set out in the second stage of the Part 1 competition test.

⁷⁷ The LTA would also need to be able to show how it arrived at the appropriate number of services required. In practice, the LTA is likely to have identified that there is unmet demand for bus services.

Accordingly, the Part 1 competition test would be failed at the second stage of the application of the test.

Improve management of peak traffic volumes

Second stage

- B.32 The objective of this element of the QPS is to reduce congestion at the bus stop and road congestion more generally in Anytown at peak travel times. Co-ordinating the timing of services between bus operators should help to ensure that services are not all arriving at the same bus stop at the same time and slowing the flow of traffic around the bus stop.
- B.33 This will help to reduce road congestion. The second stage of the test is, therefore, satisfied.

Third stage

- B.34 The QPS requires bus operators to coordinate the timings of their peak hour services to help reduce congestion. The benefits of the arrangement between bus operators to passengers in this case is that reduced levels of congestion will make for shorter journey times, which should outweigh the detriment to competition.
- B.35 Bus operators will still be competing for passengers on the route. The effect of the restriction is that there will be less vigorous competition for passengers at the bus stop at any given moment because buses will not be arriving together. However, the benefit of having a better co-ordinated service may be sufficient to outweigh the restriction of competition. Furthermore, in these circumstances, the inclusion of provisions on timings in the QPS appears to be reasonably necessary given the requirement that bus operators should co-ordinate the timings of their services.

Note

- B.36 In a multi-operator environment, a QPS specifying timings in this way would need to be achieved through a qualifying agreement between the bus operators concerned, to coordinate timetables so that operators can collectively deliver the required service timings.
- B.37 The qualifying agreement would need to be certified by the LTA and satisfy the Part 2 competition test. The Part 2 competition test (which will apply to the endorsement and certification by the LTA) is described in Annex C.

Improve coordination of bus services on key corridors supplying the hospitals

First stage

- B.38 The aim of the QPS is to improve the provision of through services to the hospital so that waiting times for passengers are reduced. There is unlikely to be any significant adverse effect on competition in this case because there were no competing services operating on the route. In fact, there will be more competition because the two bus operators will now be competing for passengers on parts of the route that were not previously the subject of such competition. The Part 1 competition test does not, therefore, need to be met.

Non-compliant

- B.39 There could be a significant adverse effect on competition if the QPS were to require the bus operators to share more cost–revenue information than was necessary for the purposes of establishing and operating the joint service. The Part 1 competition test would need to be met if this was the case.
- B.40 The reason why sharing too much cost-revenue information in this instance would fail the Part 1 competition test is because it is not necessary to secure any of the specified purposes. To be clear, it would be necessary to share some cost-revenue information but the information that is shared should be limited to that which is necessary to facilitate the provision of the through service.

Ensure fares are related to operators' costs

Second stage

- B.41 The introduction of a maximum fare, with provisions in the QPS for that maximum fare to be reviewed at specified intervals,⁷⁸ may help to prevent over-recovery of costs by operators who have invested in service improvements under the QPS. This may be the case when competition in the market is weak, the market is concentrated, and/or an operator has significant market power.

⁷⁸ Such a requirement could only be included in a QPS where there were no admissible objections from relevant operators – see new section 114(6B) of the TA2000 as inserted by section 13(6) of the Local Transport Act 2008. A detailed discussion of this provision is not within the scope of this document – see the DfT guidance on QPSs.

B.42 If, in the absence of an upper limit, fares would be higher, the introduction of a maximum fare may be of benefit to the users of the service.

Third stage

B.43 Maximum fares may in some circumstances, depending on how they are set up, have a significantly adverse effect on competition. An example of where this could be the case is set out in the following paragraph.

Note

B.44 The fact that every operator may end up charging the maximum fare might actually be a reflection of the fact that the maximum is acting as a binding constraint and achieving its purpose rather than evidence of a competition problem.

B.45 It is important, however, that the QPS does not attempt to specify an 'actual' fare (rather than a maximum fare). This would not meet the Part 1 competition test and would be unlawful. It would also be unlawful if the operators struck an agreement or reached an understanding that fares should be set at a particular level. The main point for an operator to keep in mind is that fare decisions must be reached independently. Paragraphs 5.12 to 5.14 of this guidance provide more detail about maximum fares.

B.46 The OFT has assumed in the above examples that the cumulative beneficial effect of the measures is not outweighed by the detriment to competition. However, this may not always be the case and the LTA will need to assess this on a case by case basis. LTAs should ensure that the cumulative impact, of all the measures that they include within a QPS, is proportionate⁷⁹ to the effects on competition within the scheme area.

⁷⁹ See paragraph 3.14 on the assessment of proportionality.

C APPLYING THE PART 2 TEST TO A VOLUNTARY PARTNERSHIP AGREEMENT OR QUALIFYING AGREEMENT

C.1 As noted in sections 1 and 2 of this guidance, VPAs and certified qualifying agreements are subject to the competition test in Part 2 of Schedule 10 to the TA2000. The impact on such agreements is that:

- the VPA which has as its object or effect the prevention, restriction or distortion of competition in the relevant area is not subject to the Chapter I prohibition in the CA98; the prohibition in paragraph 20 of Schedule 10 applies in its place, and the agreement is subject to the part 2 competition test
- any qualifying agreement which has the appropriate certification from the LTA will also be subject to the prohibition in paragraph 20 of Schedule 10 and will fall to be considered under the Part 2 competition test, and
- any agreement between operators which has not received the appropriate certification from the LTA falls outside the Part 2 competition test. The Chapter I prohibition of the CA98 may apply instead.

C.2 The following section considers the application of the Part 2 competition test based on the scenario set out in Annex A. The section also includes examples of situations where, in the OFT's view, the Part 2 competition test is not met in order to help illustrate how the test is likely to be applied in practice. It is assumed for these purposes that the proposals would be met through a VPA and a series of certified qualifying agreements between operators. References in this section to an 'agreement' are therefore to a VPA and a qualifying agreement which has been certified by the LTA, unless otherwise stated.

First stage: does the agreement have as its object or effect the appreciable prevention, restriction or distortion of competition in the area of the authority?

C.3 The first stage requires an assessment of whether the agreement is subject to the Part 2 competition test at all. If the agreement has as its object or effect an appreciable prevention, restriction or distortion of competition then the Part 2 competition test needs to be met. If it does not, the Part 2 competition test does not have to be met.

Object or effect

C.4 The **object** of the agreement in the Anytown scenario is to restrict competition for the purposes of improving the quality of bus services.

The agreements are also likely to have the **effect** of preventing, restricting or distorting competition as a result of the coordination of the operators' activities in relation to the supply of local bus services in order to be able to facilitate the delivery of the benefits outlined in paragraphs A.9 to A.16 of Annex A.

- C.5 The first stage of the Part 2 test requires a consideration of whether the effect on competition is appreciable.⁸⁰ If it is not, then the Part 2 competition test does not have to be met.
- C.6 Establishing whether the agreement has an appreciable effect will involve a consideration of the effects produced by the agreement on the relevant market. This in turn will depend on a number of factors, including the position of the parties within the market, the share of the market represented by the agreement, the structural characteristics of the market, and how the agreement affects, or is likely to affect, price, output, quality, and innovation.
- C.7 The agreements will specify certain requirements for bus operators in order to achieve the measures set out in paragraph A.9 of Annex A. They would not however restrict access by other operators not parties to the VPA who may be providing services on the same routes and who may also make use of the same facilities. It is therefore possible that not all of the provisions contained in the agreements as described in the scenario in Annex A, will necessarily have an appreciable effect on competition.
- C.8 For example, there is unlikely to be any effect on competition as a consequence of provisions in a VPA relating to baggage spaces on buses serving the new shopping complex. Similarly, there is unlikely to be any restriction of competition in relation to the provisions designed to increase the number of environmentally friendly buses because it will still be possible for bus operators not parties to the VPA to provide services on these routes without meeting these particular provisions set out in the VPA.
- C.9 A qualifying agreement would need to be made between bus operators in order to meet the minimum frequency requirement which is designed to increase the frequency of services on key routes. This separate agreement between bus operators would set out how they would meet the minimum frequency requirement between themselves. Providing this separate agreement does not go beyond what is reasonably necessary to meet the minimum frequency requirement, it is unlikely that there would be any appreciable restriction of competition. The Part 2 competition test therefore does not have to be met.

⁸⁰ The concept of appreciable effect is imported from Community law. See paragraph 4.14 of the guidance for further details.

C.10 We have not, therefore, included these provisions in the illustration set out below.

A practical approach to stage 1 of the Part 2 competition test

C.11 If a VPA involving more than one bus operator or qualifying agreement contains provisions relating to the timing of services, it is likely that this would have to meet the Part 2 competition test. The provisions will restrict the ability of the bus operators which are parties to the agreement in providing services at particular times independently of their competitors.

C.12 While the OFT will look at each case individually when applying the test under Part 2, it is a reasonable working assumption for LTAs and bus operators to make when they consider how the Part 2 competition test might apply to them, that restrictions relating to the timing of services contained in the agreement in question may have an appreciable effect on competition and that the second, third and fourth stages of the Part 2 competition test **will**, therefore, need to be satisfied.

C.13 The three further stages of the Part 2 competition test (described in more detail in chapter 4) are summarised below and are then applied to the agreements in our illustrative scenario. Where there is an appreciable effect on competition all of the stages of the Part 2 competition test must be met. As with the previous example that considered a QPS, we have included examples to show both how the test is met and how it might be failed to help illustrate how the Part 2 competition test would work.

Second stage: does the agreement (or series of agreements) contribute to the attainment of the bus improvement objectives?

C.14 To pass the second stage of the Part 2 competition test, an agreement must contribute to the attainment of one or more of the following bus improvement objectives:

- securing improvements in the quality of vehicles or facilities used in connection with the provision of local services
- securing other improvements in local services of benefit to users of local services, and
- reducing or limiting traffic congestion, noise or air pollution.

C.15 Each individual provision of each agreement needs to be considered. This could mean that some individual provisions might not meet the Part 2 competition test while others might stand. In such circumstances, only the provisions that do not meet the Part 2 competition test are void and unenforceable. If these provisions can be separated from the rest of the

appropriate agreement, the rest can stand and be considered under the third and fourth stages.

Third stage: does the agreement (or series of agreements) impose on the undertakings concerned restrictions which are not indispensable to the attainment of the bus improvement objectives?

- C.16 The third stage involves looking at the individual restrictions of competition that stem from the agreement. This is explained in more detail in chapter 4. For each restriction, the decisive factor is: "if the restriction were removed from the agreement, would the benefits to passengers resulting from the agreement be significantly reduced?" So long as the answer is "yes" in relation to each individual restriction such that each would be reasonably necessary, the indispensability test should normally be met.

Fourth stage: does the agreement (or series of agreements) afford the undertakings concerned the possibility of eliminating competition in respect of a substantial part of the services in question?

- C.17 The fourth stage requires an analysis of the various sources of competition in the market, the level of competitive constraint that they impose on the parties to the agreement and the impact of the agreement on this competitive constraint.
- C.18 So long as the "facilities" being provided by the LTA are available to any operator registered on the routes that are subject to the VPA and not just to those operators who are party to the agreement then the fourth stage of the Part 2 competition test will always be met because, if the facilities are open to all, the provision cannot eliminate competition. We expect that this would normally be the case, as (unlike with a QPS) there is no formal mechanism in the VPA to exclude other operators registered to operate on the routes from using the facilities provided.
- C.19 However, if the "facilities" deliver benefits exclusively to the operators who are signatories to the VPA, and competing operators would not be able to take advantage of them then it is possible that the fourth stage of the Part 2 competition test might not be met. One example of a situation might be if an LTA undertook to provide real-time information displays at bus stops, but agreed only to display information about selected operators' services. In these circumstances, any assessment would need to consider in more detail whether the provision of the facilities in question (in this example, real time bus information) would afford the possibility of eliminating competition.

- C.20 We have cited real-time information as an example just to help illustrate the assessment process that would be involved. In reality, it is difficult to envisage that such a situation would actually result in any significant elimination of competition.

Application of the Part 2 competition test to the VPA or qualifying agreement

- C.21 For the reasons given in paragraphs C.7 to C.10 above we have not considered the first three examples of the measures the agreements are designed to achieve as it is unlikely that these would restrict competition such that the Part 2 competition test would need to be met. The remaining measures are considered below.

Improve management of peak traffic volumes

First stage

- C.22 The agreement seeks to co-ordinate timings during peak hours so as to provide a regular service pattern which contributes to management of traffic flow and assists in reducing congestion. The VPA contains restrictions designed to restrict the ability of the signatories to the VPA to provide services at certain times. We have, therefore, assumed (for the reasons given in paragraphs C.11 to C.13 above) that this restriction is appreciable. The Part 2 competition test, therefore, needs to be met.

Second stage

- C.23 The objective of the agreement is to reduce congestion at the bus stop and road congestion more generally in Anytown at peak travel times. Co-ordinating the timing of services between bus operators should help to ensure that services are not all arriving at the same bus stop at the same time and slowing the flow of traffic around the bus stop.
- C.24 This will help to reduce road congestion. The second stage of the test is, therefore, satisfied.

Third stage

- C.25 The agreement requires the signatories to coordinate the timings of their peak hour services. The benefits to passengers are shorter journey times (because coordinated timings are intended to help reduce traffic congestion) and reduced average waiting times at bus stops (because the agreement should result in a more evenly-spaced pattern of services).

C.26 The principal restriction on competition is that, because different operators' buses no longer arrive simultaneously at the bus stop, there will be less vigorous competition for passengers. However, if the restrictions on timings were removed from the agreement, the intended benefits of that agreement are unlikely to be achieved. With no coordination of timings, the benefits of faster journeys and reduced average waiting times will not materialise. So the indispensability test is therefore likely to have been met.

Fourth stage

C.27 Bus operators who have not signed the VPA are not prohibited from providing services on the routes which are covered by the VPA. Provided that there are other viable operators on the market or there is a realistic possibility of entry, competition is not eliminated. If there are no other viable operators on the market and there is no realistic possibility of entry, then it is necessary to assess the degree to which participating operators still compete with each other.

C.28 In this example the competition test is met in full.

Improve coordination of bus services on key corridors supplying the hospitals

C.29 The aim of the VPA is to improve the provision of through services to the hospital so that waiting times for passengers are reduced. There is unlikely to be any appreciable restriction of competition in this case because there were no competing services operating on the route. In fact, there will be more competition because the two bus operators will now be competing for passengers on parts of the route that were not previously the subject of such competition. The Part 2 competition test does not, therefore, need to be met.

Non-compliant

C.30 There could be an appreciable effect on competition if an agreement between the operators facilitated the exchange of more cost–revenue information than was necessary for the purposes of establishing and operating the joint service.

C.31 The reason why sharing too much cost-revenue information in this instance would fail the Part 2 test is broadly the same as previously set out in paragraph B. 40 above. The Part 2 competition test would not be satisfied because it is not necessary to share the additional cost revenue information to facilitate the provision of the through service and because it would afford the possibility of eliminating competition between the

operators. For example, any one bus operator could use the information to avoid competing on routes where their rival bus operator or operators clearly has a cost advantage on a route or routes which could reduce the choice of services available to passengers and the competitive restraint on fares on that route or routes.

- C.32 In practice, the OFT does not expect that the LTA would endorse or certify such an arrangement. Such an arrangement would not, therefore, be a qualifying agreement for the purposes of the Part 2 competition test but would instead be subject to the Chapter I prohibition. The OFT is able to impose fines for breaches of the Chapter I prohibition. Where operators and the LTA are working as an effective partnership the arrangements would most likely be subject to the Part 2 competition test and not the CA98.

Ensure fares are related to operators' costs

First stage

- C.33 The restriction or limitation on the frequency with which the maximum fare could be raised or lowered would help to constrain fares. As previously noted, a provision in a VPA which sets a maximum fare may have as its object or effect an appreciable effect on competition. In such circumstances, the Part 2 competition test would need to be met (see paragraphs 5.12 to 5.14 in chapter 5). Operators should not set maximum fares between themselves. This would be a price fixing agreement within the meaning of section 39(9) of the CA98.
- C.34 An example of where competition concerns could arise in relation to maximum fares is set out in the following paragraph.

Note

- C.35 As under the QPS, the fact that every operator may end up charging the maximum fare might actually be a reflection of the fact that the maximum is acting as a binding constraint and achieving its purpose rather than evidence of a competition problem.
- C.36 What would, however, be unlawful would be if operators attempted to agree between themselves an 'actual' fare. It would also be unlawful if the operators struck an agreement or reached an understanding that fares should be set at a particular level. As under a QPS, operators must set fares independently of competitors.
- C.37 An agreement, or informal understanding or concerted practice between operators to charge the maximum fare would eliminate competition

(because it would fix the price at which services would be supplied). It would not, therefore, satisfy the Part 2 competition test and would fall for consideration under the Chapter I prohibition of the CA98. The important point for operators to note here is that fares must be determined independently. Because it is an agreement that fixes the price at which services will be supplied the Part 2 competition test will not apply.