

Predation

Cardiff Bus

Presentation by Dr Ed Smith, OFT, to EU-China Competition Week
18-20 March

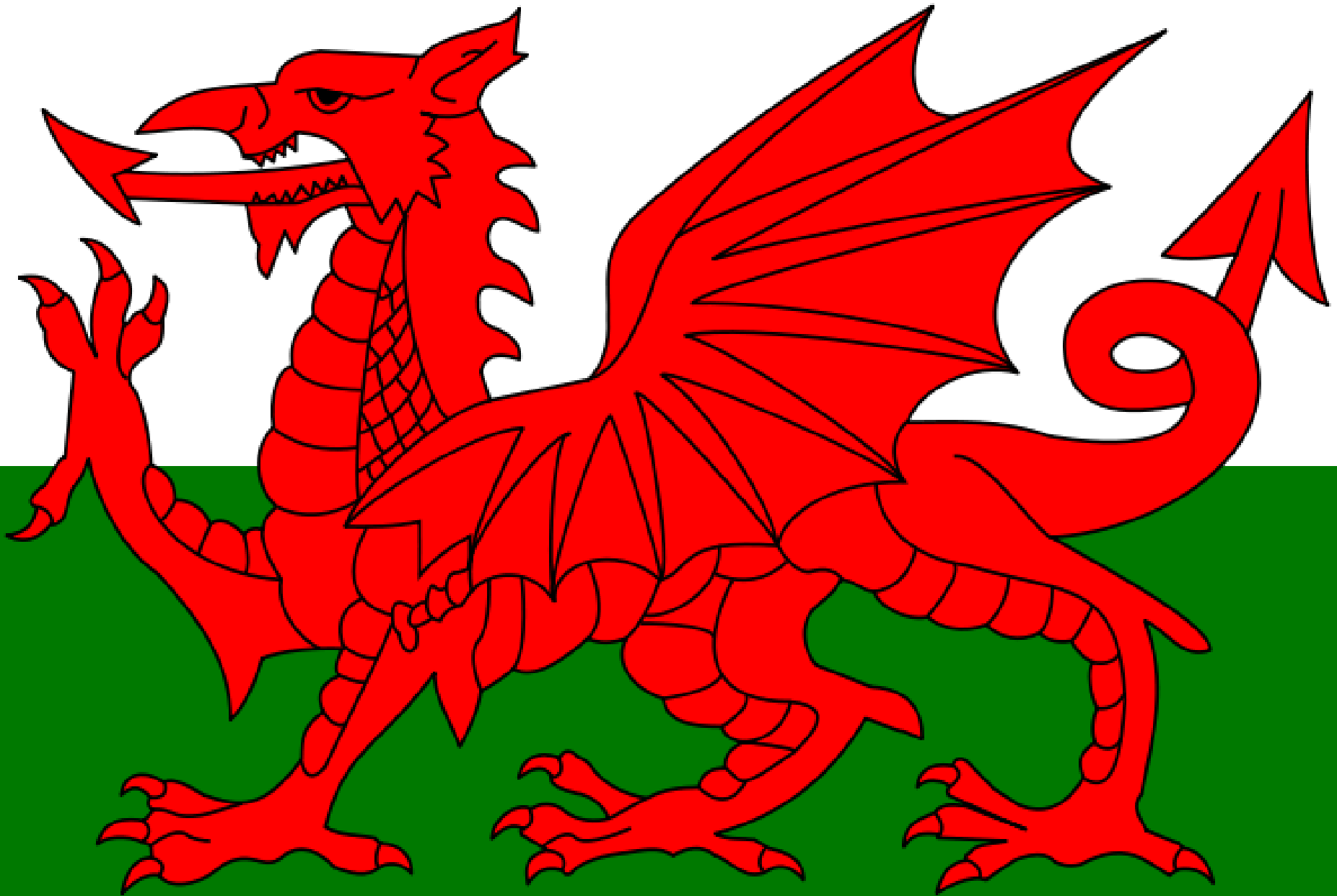
*The views expressed are those of the author and do not necessarily
Official views of the OFT

There are so many theories of predation “for the same reason that 600 years ago there were a thousand positions on what dragons looked like.” The existence of predation is as doubtful as the existence of dragons so “there is no sufficient reason for antitrust law or the courts to take [it] seriously.”

Professor Frank Easterbrook

(University of Chicago Law School)

... so where should we look for dragons?



The protagonists

Cardiff Bus (CB): incumbent

- Owned and run at arms length by Cardiff Council
- Fleet of 223 modern vehicles
- Extensive network - the 'Overground'
- Turnover of £25m in 2004/5



2 Travel (2T): entrant

- 120 vehicles, relatively old
- Used tendered services to launch commercial services in South Wales
- Low cost, "no frills" service aimed at mothers and senior citizens



What's a "no-frills" bus, exactly?

Cardiff Bus' normal service (with frills!) look like this...



Cardiff Bus' "no frills" buses (a.k.a. 'white services') looked like this...



The facts

- **Nov 03:** CB aware of 2T's plans; started preparations to react
- **Apr 04:** On same day 2T started no-frills services on 4 of CB's routes, CB started own no-frills services ('white services'), which:
 - had different livery and fares from its normal services
 - ran in same periods as 2T's services
 - ran same routes as 2T had registered (inc. a 5th route 2T never ran)
 - were priced below 2T's for 3 out of 4 zones.
- **From summer 04:** 2T had problems running services in South Wales
- **Oct 04:** CB stopped running white services on 2T's 5th route
- **Dec 04:** 2T exited; CB started withdrawing its white services
- **Feb 05:** CB stopped its last two white services
- **May 05:** 2T went into liquidation

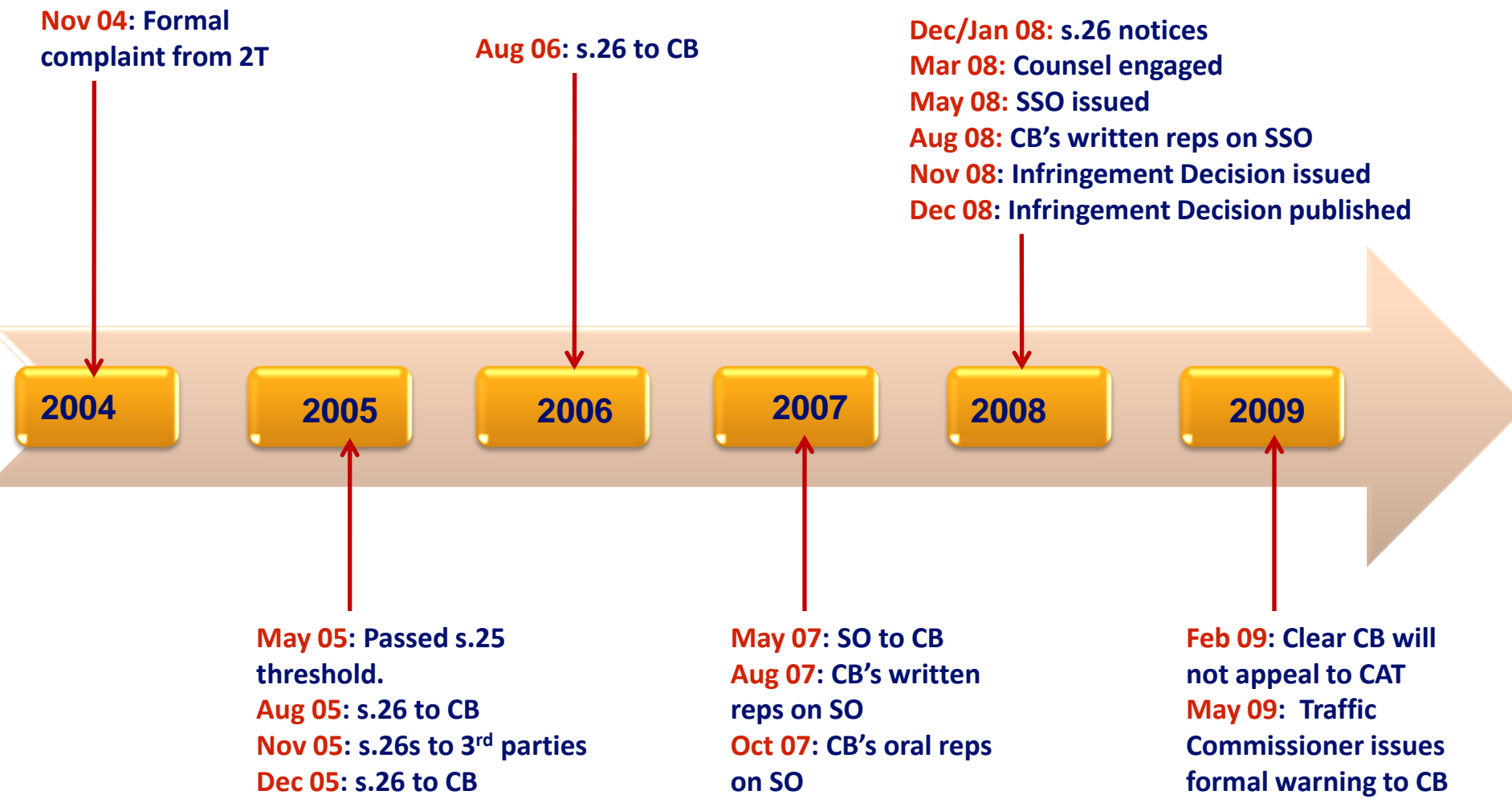


2T's formal complaint to OFT in Nov 04 that CB's actions predatory:

- CB running WS only where it faced 2T
- WS differed from normal services: older, lower quality, no livery, lower fares
- WS revenue did not cover costs
- WS lying in wait; drivers were intimidating 2T drivers. *[Traffic Commissioner investigated but found no evidence; we did not pursue further]*

CB's explanation for its conduct:

- WS were to test market for no-frills services
- WS routes were simply those most likely to be profitable
- Lower prices on WS reflected lower quality
- WS withdrawn given unexpected lack of demand and driver shortages



2. LEGAL BACKGROUND

Predation issues

- **Recoupment “possible” or “likely”? (UCWG, OFT402, Aberdeen Journals, France Telecom)**
- **“Risk of” effects on actual and potential competition**
- **Meeting/beating competition**
- **Inefficient/incompetent entry**
- **Explanations of conduct:**
 - Burden of proof (objective justification)
 - Self-incrimination
 - Unexpected result ex ante
 - Relevance of motive

3. MARKET DEFINITION

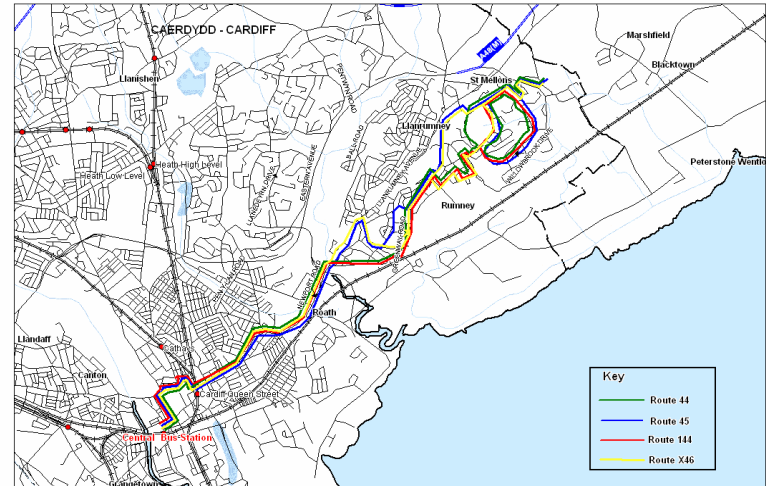
Market definition 1: The focal products

- Focused on two focal products: **flows** and the **network**.

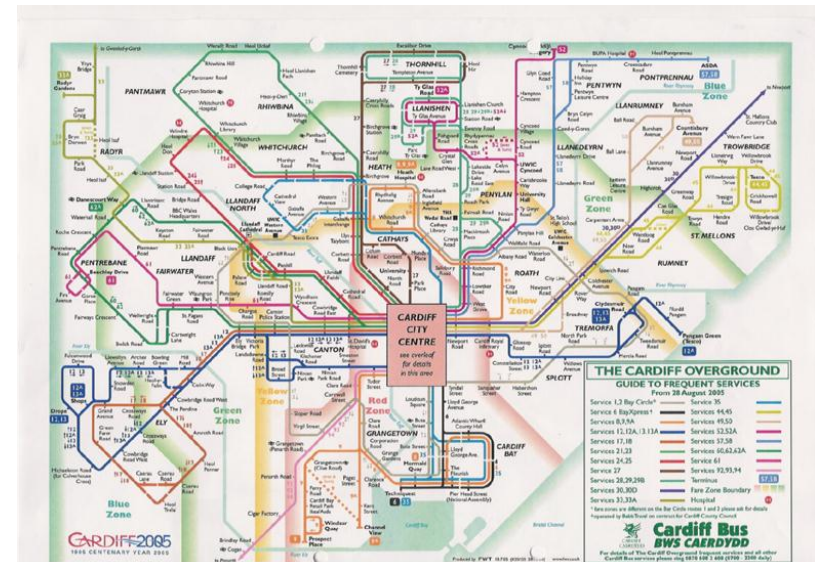
- **Flows:** Each possible point-to-point journey between bus stops on a route is called a flow.
- **Network:** Cardiff Bus operates an extensive network of 42 frequent services called the 'Overground'.

- The nature of transport services is **inherently geographic**, because consumers want to travel from an origin to a destination.

One of the no-frills routes (the '144' service):



Cardiff Bus' 'Overground' Network:



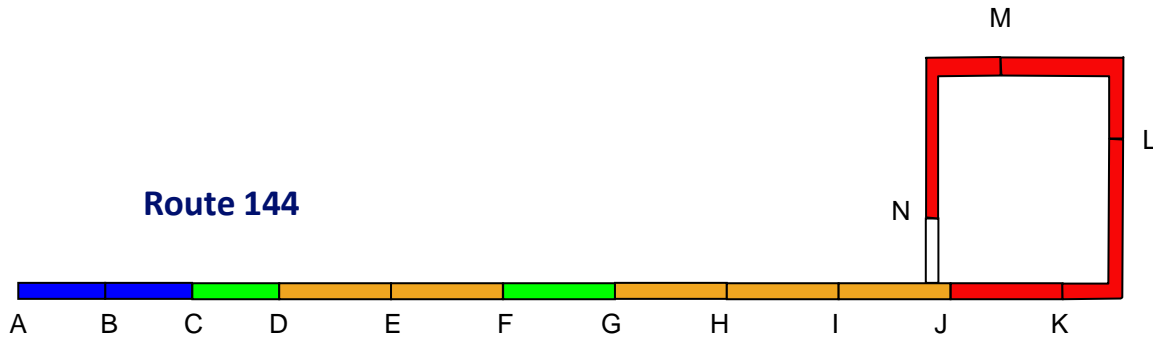
Market definition 2: The product market

The market definition included/excluded the following:

Included...
'Normal' bus services
Tendered bus services
Interurban bus services
Urban train services
Excluded...
Cycling and walking
Cars and taxis
Interurban train services

4. ASSESSMENT OF COMPETITION

Actual competition 1: Flows



Cardiff Bus had a market share on each of the small flows of **about 75%** on average across all White Service routes.

Market shares (%)

Flows	AB	BC	CD	DE	EF	FG	GH	HI	IJ	JK	KL	LM	MN
Cardiff Bus	58	58	71	82	82	72	82	82	82	81	88	88	88
2 Travel	8	8	9	18	18	28	18	18	18	19	12	12	12
Stagecoach	12	12	7	0	0	0	0	0	0	0	0	0	0
Newport Transport Limited	21	21	13	0	0	0	0	0	0	0	0	0	0

In the absence of data on passenger and revenue shares, we used the frequency of the services offered.

Actual competition 2: Network

Cardiff Bus supplied **over 66%** of bus and rail services in the network market.

Bus/rail company	Number of weekday daytime services	Share (%)
Cardiff Bus	1,202	66.2
Stagecoach	149	8.2
Arriva Trains	147	8.1
2 Travel	95	5.2
Bebb Travel	94	5.2
(Jones Motors) Shamrock Travel	54	3.0
Cardiff Bus/Newport Transport Limited	28	1.5
First	22	1.2
Stagecoach South Wales/Islwyn Borough Transport/Glyn Williams	9	0.5
Cardiff Bus/Bebb Travel	9	0.5
Newport Transport Limited	4	0.2
Sixty Six Coaches	3	0.2

Entry models

- Focused on the threat of entry from bus operators
- Potentially two types of entry model:
 - **Full service operator**: High frequency and quality services at peak hours
 - **No frills operator**: Low frequency and quality services
- Barriers to entry:
 - **Cardiff Bus network**
 - **High start up costs** (if entering as a full service operator)
 - **Cardiff Bus' reputation for responding aggressively** to new entry (if entering as a no frills operator)
 - Barriers to entry were sufficiently high to prevent and deter entry into the market

Potential competition 2:

History of entry; Conclusion on dominance

History of entry:

- With the exception of 2 Travel, there had been **no substantial market entry** or exit since at least 2000.
- There was **no evidence that major operators** were considering direct entry or expansion.
- Even Cardiff Bus, in its management plans, stated that it **expected to face 'no competition'** between 2005 and 2010.

Dominance:

- To conclude on dominance for both the flow-by-flow and the network market definition:
 - Cardiff Bus had a **market share of well over 50%**
 - **Barriers to entry in the market were sufficiently high** to deter potential entry
 - Cardiff Bus held a **dominant position** in the relevant markets.

5. FINANCIAL ANALYSIS

Failure to cover avoidable costs

- Under AKZO rules:
 - $P < AVC$ - Presumed abusive
 - $AVC < P < ATC$ - Abusive if intent
 - $P > ATC$ - Unlikely to be a problem
 - $P < AVC$ - Rebuttable (Aberdeen J)
-
- Variable costs vs. Avoidable costs
 - Average avoidable costs (AAC): Costs that could have been avoided if CB had not engaged in the activity

Which costs?

- **Avoidable costs – if CB had not engaged in activity**
- **Drivers payroll: In (but.....)**
- **Running costs e.g. fuel, tyres: In**
- **Restoration costs: Questionable (In)**
- **Depreciation: Questionable (In - immaterial)**
- **Overheads: Out**

Issue: Allocation of costs

Financial Analysis 3:

Failure to cover avoidable costs

- Revenue was **42%** lower than AAC and did not even cover Drivers' Payroll
- Revenue would have had to rise by **72 %** to equal avoidable costs.
- All the routes failed to cover AAC; AAC > revenue in **47 out of 49** periods.
- Passenger numbers needed to be **92k** higher to cover AAC

6. ABUSE

OFT's consideration

- CB did not dispute the facts of the cost/revenue analysis but disputed the relevance. CB argued the cost test could not be used as an indicator of intent because it was a failed market test.
- CB argued the analysis should be of *ex ante* expected profitability not the *ex post* analysis of costs and revenues
- We accepted this in principle, however CB's claims of a market test could not be taken at face value.
- So we set out and weighed up the:
 - Evidence **supporting** CB's explanation for its conduct
 - Evidence **contradicting** CB's explanation
 - Evidence **supporting predation** as the explanation

Evidence supporting CB's explanation

- **Little contemporary evidence** to support Cardiff Bus' explanation: only some press statements and a few newspaper reports
- **No business case** or any assessment of whether or not it was proving to be successful – impossible to assess *ex ante* beliefs of profitability where none exist
- **CB did not make use of the significant consumer research** it was conducting at the time to ask for views on no frills service

Evidence suggesting predation

- Evidence of CB's pre-planning and preparations
- The coincidence of routes and timing
- Evidence that the impact on 2T was CB's key success measure
- Evidence that withdrawal of white services was triggered by 2T's exit.
- The white services' failure to cover their costs

Evidence of Cardiff Bus' predatory intent

CB's staff recruitment flyer
for its 'Battle buses'



Cardiff Bus
BWS CAERDYDD

STAFF NOTICE

WANTED

S
T
A
F
F

PROFESSIONAL

COMMITTED

FLEXIBLE

RELIABLE

COMPANY MINDED

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If you wish to be considered for a driving role protecting your Company's status, reputation and profitability, in a highly professional manner, on routes shortly to be facing competition, please apply in writing to Dave Cole, Assistant Operations Manager by Friday 19th March 2004.

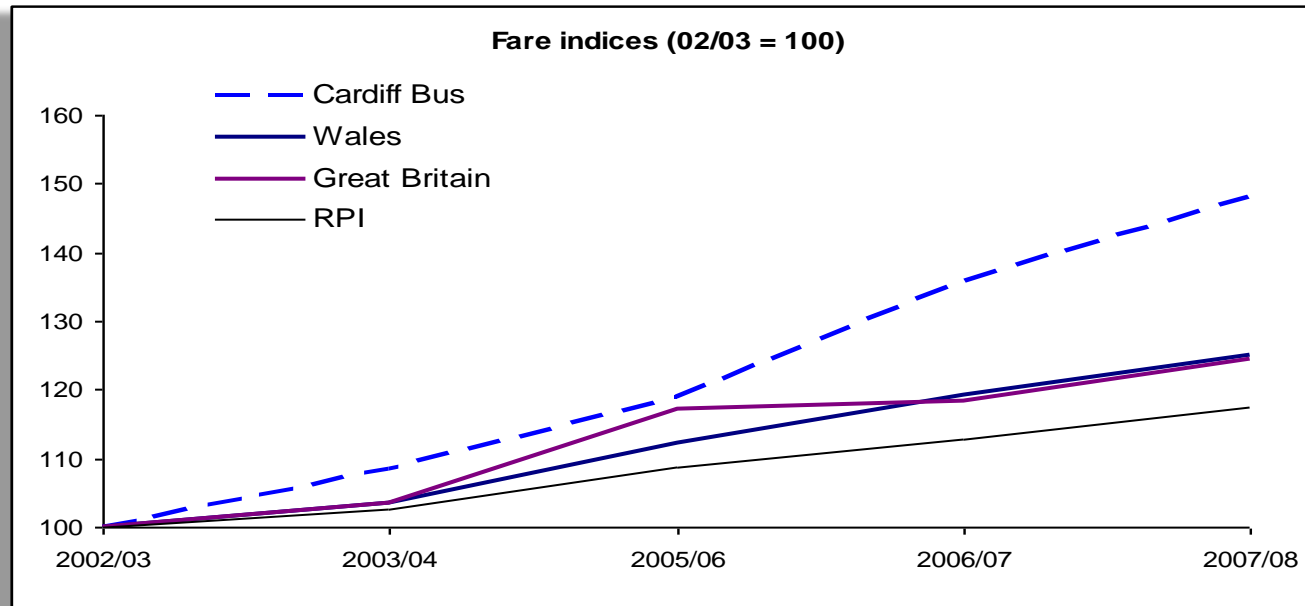
D. COLE
ASSISTANT OPERATIONS MANAGER
W620 (BATTLEBUS)
04.03.04



Why did CB predate?

- **2T was a possible threat: from discounted fares and base for expansion**
- **White services provided a targeted response, without having to reduce its fares across all its normal services.**
- **By predating on a no-frills entrant, Cardiff Bus could also:**
 - ▭ **Strengthen its reputation for making an aggressive response**
 - ▭ **Send a negative signal about the viability of the no-frills service model, deterring other potential competitors**

- Having demonstrated abuse of dominant position, no need to evidence recoupment (*Tetra Pak II*), but
- Effect on actual competition: 2T weakness was no excuse.
- Effect on potential competition:
 - Disputed evidence in the past. However the action
 - Provided an enhanced reputation for aggressive response to entry.
 - And



- **Following 2T's exit, CB increased its fares by c. 40%.**
- **Zone 1 adult single up 85%; child's single up 100%.**
- **Fare increases are above industry averages.**