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- WS withdrawn given unexpected lack of demand and driver shortages
Case Timeline

2004
- Nov 04: Formal complaint from 2T

2005
- May 05: Passed s.25 threshold.
- Aug 05: s.26 to CB
- Nov 05: s.26s to 3rd parties
- Dec 05: s.26 to CB
- May 05: Passed s.25 threshold.
- Aug 05: s.26 to CB
- Nov 05: s.26s to 3rd parties
- Dec 05: s.26 to CB

2006
- Aug 06: s.26 to CB

2007
- May 07: SO to CB
- Aug 07: CB’s written reps on SO
- Oct 07: CB’s oral reps on SO

2008
- Dec/Jan 08: s.26 notices
- Mar 08: Counsel engaged
- May 08: SSO issued
- Aug 08: CB’s written reps on SSO
- Nov 08: Infringement Decision issued
- Dec 08: Infringement Decision published

2009
- Feb 09: Clear CB will not appeal to CAT
- May 09: Traffic Commissioner issues formal warning to CB
2. LEGAL BACKGROUND
Legal Background 2: 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.
### Market definition 2: The product market

The market definition included/excluded the following:

<table>
<thead>
<tr>
<th>Included...</th>
<th>Excluded...</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘Normal’ bus services</td>
<td>Cycling and walking</td>
</tr>
<tr>
<td>Tendered bus services</td>
<td>Cars and taxis</td>
</tr>
<tr>
<td>Interurban bus services</td>
<td>Interurban train services</td>
</tr>
<tr>
<td>Urban train services</td>
<td></td>
</tr>
</tbody>
</table>
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.

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

In the absence of data on passenger and revenue shares, we used the frequency of the services offered.
Cardiff Bus supplied over 66% of bus and rail services in the network market.

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

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- Variable costs vs. Avoidable costs

- Average avoidable costs (AAC): Costs that could have been avoided if CB had not engaged in the activity
Financial Analysis 2: 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

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**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
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
Abuse 2: 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
Abuse 4: 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
Abuse 5: Evidence of Cardiff Bus’ predatory intent

CB’s staff recruitment flyer for its ‘Battle buses’

Cardiff Bus
BWS CAERDYDD
STAFF NOTICE

WANTED

PROFESSIONAL

COMMITTED

FLEXIBLE

RELIABLE

COMPANY MINDED

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 13th March 2004.

D. Cole
Assistant Operations Manager
04.03.04
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
Effect on competition and feasibility of recoupment

- 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.