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Consultation response

**Public Transport Ticketing Schemes  
Block Exemption Review (CMA)**

September 2015

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## 1. Introduction

- 1.1. **pteg** represents the six English Passenger Transport Executives<sup>1</sup> (PTEs) in England, which, between them, serve more than eleven million people in Tyne and Wear, West Yorkshire, South Yorkshire, Greater Manchester, Merseyside and the West Midlands. Nottingham City Council, Transport for London (TfL), the West of England Partnership and Strathclyde Partnership for Transport (SPT) are associate members of **pteg**.
- 1.2. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of delivering integrated public transport networks accessible to all. Our core responsibilities include:
  - Helping passengers make sense of their public transport network by providing impartial and comprehensive information;
  - Making public transport more affordable by running concessionary fare schemes and by promoting and, in some cases, administering integrated ticketing schemes.
- 1.3. We therefore welcome the opportunity to respond to this consultation document.

## 2. Response

### Q1. Do you agree with renewing the Block Exemption?

- 2.1. Yes, we fully agree with the assessment in paragraphs 3.3 – 3.11 of the consultation document and strongly support the CMA's proposal to recommend to the Secretary of State that the Block Exemption (BE) be renewed for a period of ten years. The products enabled by the BE are not only highly valued by consumers but, in our view, also contribute to a more sustainable, efficient and competitive transport market.
- 2.2. According to our estimates, around 160 million public transport trips are made in PTE areas every year, which make use of ticketing products covered by the PTTS Block Exemption<sup>2</sup>. This equates to over 12% of the overall local public transport market<sup>3</sup>. If we exclude free concessionary trips made by elderly and disabled people, then the share of local multi-operator products jumps to around 16%.
- 2.3. This observed level of demand suggests that integrated ticketing schemes provide significant benefits to passengers and society at large, namely:
  - Cheaper and more convenient travel alternatives;
  - Increased perceived frequency on corridors where on-street competition takes place;
  - Reduced congestion and externalities due to reduction in car use.
- 2.4. Operators also stand to benefit through:

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<sup>1</sup> Some PTEs have been abolished with their functions transferred onto successor bodies, such as Combined Authorities. In this response, we take PTEs to mean both single purpose metropolitan transport authorities and their successor bodies where relevant.

<sup>2</sup> 46 million rail trips (based on RiN demand and revenue model and PDFC PTE tickets Phase 2 report); c. 113 million bus trips (adult and child) based on pteg met bus model; tram/light rail trips likely to be 5-10m.

<sup>3</sup> 1,058 million bus trips; 159 million local rail trips; 82 million tram/light rail trips.

- Increased attraction of passengers who would otherwise travel on competing modes;
- Increased viability of public transport networks;
- Lower operating costs due to reduced boarding times. Our analysis suggests that if all bus passengers were to switch to pre-paid tickets bus operating costs could fall by 3% due to lower journey times and demand would increase by 3.8%<sup>4</sup>.

- 2.5. In our view, there are two key properties of integrated ticketing schemes which explain their popularity and wider benefits. On the one hand, they allow **price differentiation** to take place. Without such products, operators would be unable to identify those passengers who must rely on more than one service and who have therefore higher propensity to switch to competing modes. By singling out those passengers integrated tickets allow operators to lower their mark-up and price closer to marginal cost. It has been shown<sup>5</sup> that, under monopolistic conditions (as could be argued is partly the case for local bus markets), price differentiation leads to a welfare maximising outcome.
- 2.6. The other important feature of integrated ticketing schemes is that they can remove part of the intrinsic complexity in making multi-modal or multi-operator journeys. It has been pointed out by a number of authors<sup>6</sup> that there is a non-negligible **transaction cost** involved in making complex journeys. By removing much of this complexity, integrated tickets can effectively reduce the overall cost (including monetary and non-monetary components) of making a trip. We would argue that, even if integrated schemes were to lead to higher prices<sup>7</sup> in some cases, the reduction in transaction costs is likely to outweigh the change in price.

### Q2. Do you consider the continuation of the Block Exemption to be necessary to deliver integrated ticketing schemes that are beneficial to consumers?

- 2.7. We are in agreement with the CMA's view that *"there is a significant and real risk that, without the Block Exemption, some operators would be reluctant to join public transport ticketing schemes"* for the reasons given in paragraph 3.10 of the consultation document.

### Q3. Would consumer choice be significantly reduced without the Block Exemption?

- 2.8. Yes.

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<sup>4</sup> PTEG (2010), BSOG Devolution – Funding More Effective and Sustainable Bus Networks, Internal Report.

<sup>5</sup> Boiteux M. (1956), Sur la gestion des monopoles publics astreints à l'équilibre budgétaire, *Econometrica* **24** (1956), (published in English as "On the management of public monopolies subject to budgetary constraints". *Journal of Economic Theory* 3, 219–240). Ramsey, F. (1927), A contribution to the theory of taxation, *Economic Journal* **37/1** (1927).

<sup>6</sup> For a summary, see Bonsall PW, Shires JD, Matthews B, Maule J and Beale J. (2007) Responses to Complex Pricing Signals: Theory, Evidence and Implications for Road Pricing, **Transportation Research A** 41 (A), 672-683. See also the report by 2009 report by Booz&Co for pteg, which sets out some of the benefits of simplified and integrated ticketing in public transport, based on available case studies.

<sup>7</sup> Our previous discussion on price differentiation actually suggests that integrated tickets are likely to lead to lower prices for those passengers making multi-leg journeys. This issue is addressed again at a later point in our response.

- 2.9. In addition to the points made in paragraph 3.10 of the consultation document, it is important to note that, due to network effects, the absence of multi-operator ticketing schemes can act as an important barrier to entry and expansion in local bus markets. This was one of the significant findings in the Competition Commissions 2010-11 investigation into the local bus market, which we feel should be more clearly acknowledged in the CMA's review of the BE.
- 2.10. Indeed, over the past decade, PTEs have observed a growing market share for the largest operators' prepaid/discounted tickets, often at the expense of multi-operator products. This has been achieved, in part, by a widening differential in the price difference (the premium) between single operator and multi-operator tickets, which is, in large measure, determined by the biggest operators<sup>8</sup>. We see this, amongst other things, as an attempt to shield from potential competition.
- 2.11. This has two effects: (1) it increases the cost of travel for passengers which must rely on the services of two or more operators, relative to passengers making similar trips but who, purely by chance, must rely on the services of more than one operator; and (2) it can severely reduce the likelihood of sustained competition from smaller operators and ultimately lead to a more concentrated, and less competitive, market.
- 2.12. The second point is supported by the Competition Commission's own analysis and we will therefore not repeat its arguments. However, we think it could be useful to illustrate how this plays out for the tendered bus market which, many have argued, is critical for ensuring that the commercial bus market remains contestable<sup>9</sup>.
- 2.13. Whilst the commercial bus network can be seen as a spatial oligopoly shared between up to three large operators<sup>10</sup>, most often controlling separate but adjacent geographical areas, there are also several smaller independent companies in each metropolitan area. Although these companies run a small proportion of commercial services, they are fairly active in the tendered market and many are likely to depend on local authority contracts for their financial viability.
- 2.14. Many tendered services run in the early morning and late evening, just before or after concurrent commercial services, and will therefore share passengers with the commercial operator. Where these tendered services are allocated on a gross cost basis, multi-operator tickets can help promote competition by allowing smaller operators' services to carry passengers who would otherwise be locked into the incumbent operators' discounted product. This reduces risk and increases revenue and patronage, thereby allowing smaller operators to compete.
- 2.15. We note that the Competition Commission proposed greater availability of multi-operator tickets as one of the key remedies, following its investigation. We touch on this point again in our response to question 9.

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<sup>8</sup> Largest operators set the price of their own single operator discounted products, which, given the size of their network, are the main alternative to multi operator products, and they also hold a de facto veto over the price of multi-operator tickets.

<sup>9</sup> See, for example: Mackie, P.J. and Preston, J. (1996), *The Local Bus Market*. Avebury; and the outputs from the Competition Commission's investigation.

<sup>10</sup> NERA (2006), The decline of bus services in PTE areas. Available: [http://www.pteg.net/NR/rdonlyres/94260D61-2AE0-4B51-90D3-5E69BEF1CD6A/0/NERA\\_Decline\\_in\\_Bus\\_Services\\_September\\_2006.pdf](http://www.pteg.net/NR/rdonlyres/94260D61-2AE0-4B51-90D3-5E69BEF1CD6A/0/NERA_Decline_in_Bus_Services_September_2006.pdf)

#### Q4-7

We have no comment on these questions.

#### Q8. Would a longer duration for the Block Exemption be desirable?

- 2.16. Our view is that greater long term certainty is generally of value to the industry. After several years of working with the Block Exemption, we have no evidence that it has any adverse effect on the functioning of the local public transport market and we do not anticipate that any adverse effects will arise in the future.
- 2.17. We would therefore suggest that the Block Exemption should be extended for the longest period practicable, but with the opportunity to periodically review and, if appropriate, extend its scope.

#### Q9. Do you agree with the assessment outlined in Chapter 5 of the consultation document?

##### *MTC pricing (paragraphs 5.5 – 5.8)*

- 2.18. As we argue above, multi-operator tickets are likely to have a positive effect on competition and the contestability of the local bus market. However, this requires the price of multi-operator tickets (MOTs) to be close enough to the price of single operator tickets in order for them to remain competitive for a large enough share of the passenger market. This is why the Competition Commission proposed that there should be a mechanism for imposing a **maximum** premium on MOT prices.
- 2.19. We are therefore confused by the analysis set out in the CMA's consultation document, and in particular the statement in paragraph 5.7 that "*by linking the MTC price to an operator's own travel card the price restraint of the MTC on the operator's own travel car and its fares would be removed*". This is the basis for the recommendation not to allow the price of an MTC to be automatically linked to the price of existing single operator tickets, which we do not agree with.
- 2.20. We believe that paragraph 5.7 potentially reflects a misunderstanding by the CMA of the price setting mechanism that operates in practice. Based on our experience, the largest bus operators first set the price of their own pre-paid/multi-trip/period products (carnets, dailies, weeklies, monthlies, etc) at a given discount over their cash fares. If we were to treat these operators as monopolists and assume that the price of cash fares is set separately then the discount offered should be the lowest possible just so as to induce frequent passengers to trade up to a pre-paid ticket. We need to also remember that the largest operators have a competitive advantage as the result of network economies (ie, their products can be used on a larger network of, typically, more frequent services than those of smaller competitors). Where there is competition or the threat of competition, they can therefore still afford to price above competitors, even before we bring in the potential for active anti-competitive behaviour.
- 2.21. Once the largest operator has decided on the discount offered by their own period tickets, they are then in a position to agree the price of multi-operator tickets (MTCs) with other operators. Based on this scenario, it is clearly in the interest of the largest operators to make the differential between the price of their own discounted products and the price of the MTC as large as possible. It can be taken as a given that the largest operator would not typically

agree to an MTC price that were to undercut its own equivalent discounted products. The question is therefore how big can the largest operator make this premium (so as to keep the competition out). In other words, the price of an MTC follows from the price of other tickets and not the other way round, as suggested in the consultation document. In other words, the MTC exercises no constraint on the price of other tickets, at least at the point at which the price is being set. Of course, if an MTC is priced more competitively, and this in turn helps support a greater degree of competitive discipline, then, in the longer term, this could bring all ticket prices down.

- 2.22. As we understand it, the purpose of the Competition Commission's proposal to devise an MTC price setting formula was precisely to give smaller operators and third parties, such as local transport authorities, greater power in setting the price of the MTCs, in the hope that this would ultimately make MTCs more attractive. We therefore cannot make sense of the argument set out in paragraph 5.7.
- 2.23. In our view, the BE should allow the price of an MTC to be set in accordance with the formula proposed by the Competition Commission (which implies a maximum premium). However, as we understand it, this is not necessarily precluded by the BE in its current form. We would welcome further discussion with the CMA in order to achieve greater clarity on this issue.

#### ***MIT pricing and revenue allocation (paragraphs 5.15 – 5.20)***

- 2.24. As we argue above, there are likely to be benefits to passengers from the availability of fairly priced multi-operator products. These come in the form of both a less complex pricing offer and a more competitive market. As we recall, the Competition Commission argued that, in the interest of competition, equivalent and fairly priced multi-operator tickets should be available for any geography or time period for which single operator tickets are available.
- 2.25. We therefore believe that there would potentially be benefits from allowing MTC schemes (i.e., multi-operator tickets sold at a fixed price) to operate on corridors or at times when they may only be used on the services of two different operators. Accordingly, operators should be allowed to agree a fair revenue allocation mechanism to support such a ticketing arrangement. We would therefore encourage the CMA to re-consider its preliminary recommendation not to relax pricing and revenue allocation constraints on MIT (ie, two operator inter-operable ticketing) schemes.

#### ***Issues relating to smart tickets (paragraphs 5.21 – 5.41)***

- 2.26. We largely agree with the CMA's analysis in respect of smart ticketing and welcome its intention to "*ensure that the ticket definition [in the Block Exemption] is extended to include all forms of smart tickets*".
- 2.27. As we argue earlier, multi-operator tickets are essential to ensuring a more competitive public transport market and deliver significant benefits to consumers. Smart ticketing creates the opportunity to introduce new and more convenient multi-operator ticketing products. In our view, it is important that competition rules support these emerging developments.
- 2.28. Further to the proposals in the consultation document, we would therefore encourage the CMA to consider whether there might be ways in which the Block Exemption could be extended to facilitate the introduction of new multi-operator products on smart media, without the need to consult the CMA.

- 2.29. One suggestion put forward by some of our members would be to exempt any smart products falling outside the precise definitions set in the Block Exemption, following a certification process whereby Local Transport Authorities would verify that the proposed ticketing product complied with the relevant aspects of the Part 2 competition test in the 2000 Transport Act.
- 2.30. It has also been suggested that, in some cases, there could be benefits to passengers (for example, in the form of a simpler and more attractive fares structures or a market more open to entry and expansion) if individual operators were to agree to withdraw their own discounted products which are in competition with a multi-operator ticket. While such a decision, made unilaterally by an individual operator, is unlikely to fall foul of competition law, there is a risk that this could be seen as anti-competitive if done in a more coordinated way. One of our members would therefore like to see this scenario made explicitly covered in the Block Exemption.

**Q10. Have there been any developments, in particular in ticketing technology and products, in the last five years or are any expected over the next five years that affect the Block Exemption and would require, in your view, a change in its terms?**

- 2.31. We largely agree with the CMA's analysis in paragraphs 5.21 to 5.41, and with its preliminary recommendations, in particular around greater clarity in the elements of the Block Exemption that would apply to emerging ticketing products.
- 2.32. However, we would also propose that the CMA sets out to undertake a regular consultation (e.g., every two years) on the scope of the BE in relation to emerging smart ticketing products.
- 2.33. See also our points in paragraphs 2.27 to 2.30 above.