

Agenda

Advancing economics in business

A new route for predation? The High Court ruling in the *CCT v Arriva* bus case

Predatory pricing cases in the UK bus industry are legendary. Following a trend for commercial disputes to be settled by private actions rather than through competition authorities, Chester City Transport alleged that Arriva's entry onto a number of its bus routes amounted to predatory behaviour. Earlier in 2007, the High Court found that, on the basis of economic evidence, despite a strong position in the area around Chester, Arriva could not be deemed to be dominant. This ruling has relevance for future Article 82 cases

Private litigation is a fast-developing area of European competition law. In December 2005, the European Commission published its Green Paper on encouraging private damages actions for breaches of competition law, and a White Paper is scheduled to be published shortly.¹ Many of the initial instances of private antitrust litigation are expected to be 'follow-on' damages claims, where private litigation follows the decision of a competition authority, particularly in cartel cases. However, a second type of action relates to 'original' actions, where litigation is initiated in the absence of a decision from a competition authority. These cases are primarily disputes between businesses under Articles 81 (agreements) or 82 (abuse of dominance) of the EC Treaty. Leaving such cases to private actions has advantages from the perspective of competition authorities, as it releases resources from these types of commercial dispute, which can then be used to investigate hard-core cartels and cases where small businesses and individual consumers are the parties harmed.

This article examines one of the first examples of the latter type of case to reach the UK courts. *Chester City Council v Arriva plc*² involved a claim that Arriva had engaged in predatory conduct in the local bus market in and around Chester, a city located in the north-west of England.³ The case is important not only because it stands as one of the first original actions in UK competition law in which a judgment has been issued (many cases settle beforehand), but also because it provides a detailed, and in some ways unprecedented, treatment of the economics of the bus industry. Furthermore, the judgment stands as an effects-based analysis of an abuse of dominance case; as such, it may be an indication of the type of judgment which will become more common if the European Commission's

aim of moving to a more economics-based approach to the application of Article 82 is fulfilled.

The overall approach in this judgment shares some similarities with that adopted by the Office of Fair Trading (OFT) in *First Edinburgh* (2004), where an effects-based approach was taken, which led to a finding that there had not been an abuse of a dominant position.⁴ This is in contrast to earlier findings of predatory actions in various cases in the UK bus industry in the 1990s, including the celebrated Monopolies and Mergers Commission case, which centred around the actions of Stagecoach in Darlington.⁵

CCT v Arriva: background

In June 2006, Chester City Transport (CCT) was put up for sale by its owners, Chester City Council (CCC), due to its financial weakness and failure to invest in the business over preceding years.⁶ CCT, one of the last remaining bus companies in the UK under the ownership of local government, was the main operator within the city of Chester. However, it did not run longer-distance services to and from Chester—these were instead operated by Arriva and First Bus, two of the five largest bus operators in the UK as a whole.

When CCT was put up for sale, Arriva's initial reaction was to try and persuade CCC that, rather than conduct a formal bidding process for the company, CCC should enter exclusive negotiations with Arriva for the sale, on the basis that Arriva was the bidder best placed to acquire the company.⁷ At the same time (early September 2006), Arriva registered duplicates of all of CCT's commercial services, with the same bus numbers and at the same departure times, to take effect the following January. This duplication of CCT's network by

Arriva led to immediate litigation from CCT, on the basis that Arriva's actions were an abuse of a dominant position under the terms of the Competition Act 1998.

However, before this case could come to court, Arriva altered its registrations. Rather than replicating CCT's entire network, Arriva's amended registrations involved operating only the three most profitable routes of CCT, at the most profitable times of day. Furthermore, the services were no longer to run at identical times to those of CCT. Nevertheless, CCT persisted with its claim, stating that these revised registrations also represented an abuse of a dominant position.

Market definition in *CCT v Arriva*

The product market definition adopted in this case started from the smallest possible market, which was commercial bus services. An important question addressed by the Court was whether tendered and commercial services should be considered as being in the same relevant market. In this case, both of the expert witnesses agreed that they should. This conclusion was reached on the basis of supply-side substitutability—ie, the same bus could be used for a tendered or commercial service. The judgment did not determine whether train journeys were in the same relevant market, as this was not critical to the final decision (some of the rail stopping services had important point-to-point overlaps with certain bus routes in the market).

An issue subject to greater dispute was the *geographic* market definition. In previous competition cases concerning the UK bus industry, geographic market definition was typically not critical to the conclusions reached—however, in *CCT v Arriva* it was. Arriva has a large presence in the areas surrounding Chester, while CCT was the largest operator in the city of Chester itself.

The *First Edinburgh* case involved a market definition that made use of concepts first set out by the Court of First Instance in its *Tetra Pak* judgment.⁸ The markets in question were defined on the basis of supply-side considerations. The OFT noted that all routes within the catchment area of a single depot might form part of the same geographic market, since, in response to a price rise by a hypothetical monopolist, buses could be switched between routes.⁹ The relevant geographic markets were based around the depots of the two main bus companies active in Edinburgh and its hinterland. Two markets were considered—a Greater Edinburgh market, and a Surrounding Area market. Of particular interest in this case was the OFT's view that there might be potential to leverage market power from one of these markets into the other, on the basis of 'associative links' between them. This concept, first set out in *Tetra Pak*,

refers to markets that are economically separate but sufficiently closely related for a dominant position in one market to affect competition in the other. As such, in this case, the OFT believed that a dominant position in the market surrounding Greater Edinburgh might have provided First with the potential to abuse that dominant position in the market of Greater Edinburgh.¹⁰

In *CCT v Arriva*, the geographic market was defined by supply-side substitutability into the routes served by the various bus companies active within Chester's urban area, since there was no meaningful demand-side substitutability between different bus journeys. The important issue then became the extent to which various bus companies could substitute their services into the market in the event of a rise in the price of bus tickets by a hypothetical monopolist. There was agreement between the experts that the first step in the process of determining supply-side substitutability was to identify the bus depots from which Chester city centre could economically be served. In this respect, the approach was similar to that adopted in *First Edinburgh*.

However, the Court's overall findings regarding geographic market definition differed substantially from the *First Edinburgh* precedent, particularly as regards the precision of, and the economic rationale for, the markets defined. The geographic market was defined on the basis of an isochrone around the centre of Chester, which denoted those locations from which Chester's central bus exchange could be reached within 30 minutes' (or, as a sensitivity test, 25 minutes' and 35 minutes') drive time by a bus. The Court found that time spent in 'dead-running' a bus was the critical factor in determining whether Chester could be efficiently served by a bus operating from a particular depot. The use of isochrones enabled the relevant geographic market to be determined more precisely than in previous competition cases involving the bus industry, and the Court explicitly rejected an approach of determining the geographic market on the basis of administrative districts. This is in contrast to, for example, the earlier *Arriva/Sovereign* case, where one of the relevant defined markets was the county of Hertfordshire as a whole.¹¹

The Court was also careful to define the direction in which supply-side substitution can occur, and the influence that this has on geographic market definition (there was disagreement between the experts on this). It was noted by the judge that only supply-side substitution *towards* the focal market should be taken into account when assessing geographic market definition. That is, if a depot were able to supply the city of Chester, it should be included in the relevant market. Effectively, the assessment of geographic market definition could be considered as taking each point which might be in the

relevant market, and considering whether a hypothetical depot located at that point would be able to profitably supply Chester city centre. If it could, that point should be considered as being in the relevant market. However, not all points which could be supplied by a depot able to supply Chester city centre should be included in the market; to include areas which could be supplied by such a depot, but which are in the other direction from Chester city centre, would lead to overly broad geographic markets. For example, if a depot were considered able to serve an area around itself of 30 minutes' drive time, to also allow substitution away from the focal market would create a geographic market of 60 minutes' drive time where there was a depot precisely on the boundary of the market. This would be erroneous, since depots located at a distance of 55 minutes' drive time (which would not be able to serve Chester economically) would be placed in the relevant market.

Determining the market share metric and dominance

The market share metric was also important in *CCT v Arriva*, and again differed from that employed in previous cases involving the bus industry. Earlier cases used a range of metrics for determining market shares, including bus mileage and turnover. Market shares were largely determined on a pragmatic basis, with the competition authorities using whichever measure for which the various companies in the area could easily provide consistent data.¹²

There were two potential market share metrics examined by the High Court in *CCT v Arriva*—bus hours in service, and the number of buses owned by each firm. Of these alternative measures, the one chosen was the number of buses which each company had available to it. In order to be counted, these buses had to be based at a bus depot *within* the geographically defined market. No distinction was made between buses of different sizes—a 20-seat and a 40-seat bus were considered to be equal for the purposes of determining market shares.

This measure was one of capacity, in contrast to previous cases, which had used either activity measures (bus mileage) or revenue measures (turnover). The Court adopted the use of capacity measures on the basis that they were the best reflection of market power in a market defined on the basis of supply-side substitutability. Capacity was defined in two different ways during the trial:

- the number of buses operated by each company;
- depot capacity.

Although these two measures are related, they are not necessarily directly proportionate, and any differences

will reflect the extent to which different companies have different levels of capacity utilisation at their depots. The Court appeared to accept that both of these measures of capacity were potentially relevant.

This sets an important precedent for future cases in the bus industry in terms of an economically based approach to determining market shares—ie, that the market share metric chosen should depend on the competition issue being addressed, and the characteristics of the defined market.

Market shares were therefore calculated on the basis of the number of buses and capacity available to each operator in their depots that were located within the scope of the relevant isochrones around Chester. The Court did not reach a firm conclusion on the precise scope of the geographic market, and instead considered market shares for Arriva under a number of scenarios. It held that the market share for Arriva did not exceed 32% in any of the scenarios, which was the upper limit of the market shares derived on the basis of:

- bus numbers in the various sizes of isochrone;
- different definitions of capacity;
- other sensitivity tests assessed in the case.

As a result, the Court found that Arriva was not dominant in the bus market around Chester. However, there was a further finding which may be significant for future allegations of predation in the bus industry. The Court found that, even if CCT's estimates of Arriva's market share (53%) had been correct, there would not have been a finding of dominance in this market. This was because the market was found to be a contestable one, in which entry on specific routes was achievable at very low cost, and exit was equally easy. If adopted in future cases, this concept may make it difficult to sustain a finding of predation in the bus industry (at least provided that any entry were on a relatively small scale). As such, this again represents a more economically literate approach to determining dominance than an approach that assumes that all market shares above a given level result in a presumption of dominance, and would be in accordance with the European Commission's proposed changes to the treatment of cases under Article 82.

Conclusion

CCT v Arriva provides an important precedent in a number of areas.

- It reflects the growing trend for competition policy disputes between companies to be settled via private litigation, rather than through complaints to competition authorities. Since predatory pricing is a type of conduct that tends to involve the complainants

being competitors rather than customers, it can be expected that a substantial proportion of future predatory pricing claims in the UK will be settled through private actions.

- It also alters the assessment of competition issues in the bus industry. Earlier cases have been form-based, and have often made use of loose market definitions and market share metrics which were not the most appropriate for considering market power in the market in question. In *CCT v Arriva*, the Court adopted an approach of looking again at the fundamental principles and concepts underlying the determination of dominance, without a heavy reliance on previous cases dealing with similar issues. This led

to both a more accurate geographic market definition than had been used in previous cases, and a determination that the market was one in which entry barriers were sufficiently low to make the market contestable.

These are important precedents to be borne in mind for future predation cases under Article 82 in general, and for the bus industry in particular, if indeed the bus industry retains its current competitive nature. The UK government is considering a move to a competitive-tendering-based system designed to reduce any undesirable effects of aggressive 'destabilising' competition between buses.¹³

¹ European Commission (2005), 'Damages Actions for Breach of the EC Antitrust Rules', Green Paper, COM(2005) 672 final, December.

² *Chester City Council & anor v Arriva plc & ors* [2007] EWHC 1373 (Ch), Judgment of June 15th 2007. For an overview of the case, see Patton, C. and Lee, J.(2007), 'Lessons for Private Enforcement: Chester City Council v Arriva', *Competition Law Journal*, 6:3, pp. 187–94.

³ Dr Gunnar Niels, Oxera Director, acted as expert witness during the trial.

⁴ Decision of the Office of Fair Trading No. CA98/05/2004, *First Edinburgh/Lothian*, 29 April 2004.

⁵ Monopolies and Mergers Commission (1995), 'The Supply of Bus Services in the Northeast of England'.

⁶ *CCT v Arriva*, para 43.

⁷ *Ibid.*, para 56.

⁸ Judgment of the Court of First Instance (Second Chamber) of 6 October 1994. *Tetra Pak International SA v Commission of the European Communities*, case T-83/91, para 106.

⁹ *First Edinburgh*, paras 26 and 27.

¹⁰ *Ibid.*, para 48.

¹¹ Competition Commission (2005), 'Arriva plc and Sovereign Bus & Coach Company Ltd', January. One reason for the difference may be that the Commission considered that the fact that tendered services were paid for by a single awarding authority throughout Hertfordshire (Hertfordshire County Council) meant that, in the event of price rises, the Council would substitute between different tendered services, leading to demand-side substitutability between different routes.

¹² For example, in *Arriva/Sovereign*, the main measure used was registered bus mileage; in *First Edinburgh*, both bus mileage and turnover from the routes in question were used.

¹³ Department for Transport (2007), 'The Local Transport Bill Volume 1: The Government's Response to the Consultation', p. 10.

If you have any questions regarding the issues raised in this article, please contact the editor, Derek Holt: tel +44 (0) 1865 253 000 or email d_holt@oxera.com

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