SUBMISSION TO

THE OFFICE OF FAIR TRADING
MARKET INVESTIGATION BRANCH

ISLE OF WIGHT
FERRY SERVICES

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1. Introduction

As the Member of Parliament for the Isle of Wight I am particularly concerned about the provision of services to my constituents and the economic wellbeing of my constituency.

Perhaps the most important transport service for the Isle of Wight is that provided by the ferry companies to transport passengers (both residents and visitors), private and business vehicles and freight to and from the Island. For as long as I have been the Island's Member of Parliament I have received numerous complaints from my constituents, local businesses and visitors to the Island about the very high prices charged for use of the ferry services and most particularly the pricing structure applying to residents and local businesses.

The Isle of Wight is the largest parliamentary constituency in the United Kingdom with almost 109,000 registered electors and around 136,000 permanent residents. Tourism is estimated to increase the population at any one time to around 300,000 during the summer months.

Although the Isle of Wight has many advantages and is undoubtedly a beautiful place to live this masks areas of relatively high deprivation. Four wards on the Island are amongst the most deprived 25% in England and gross domestic product (GDP) is 30% lower than average. Some 18% of are in receipt of income support (the highest proportion in the South East) and 25% of Island residents receive means tested benefits. There is a high proportion of retired and economically inactive residents.

It is important to understand that the ferry services are an integral part of life on the Isle of Wight. The size and nature of our economy dictates significant dependence on the import of materials and goods from the mainland and the export of other goods including food and manufactured items to the mainland and beyond. Isle of Wight Council figures show that tourism to the Isle of Wight generates £360 million direct expenditure, which represents a significant proportion of the Island's economy and supports over 20% of local jobs.

Much travel by residents to and from the mainland is non discretionary. Journeys are undertaken for essential hospital treatment not available locally, for access to specialised further education and all higher education and by commuters either because they work on the mainland or in some other connection with their employment. Currently the only help available from any central government agency is for those on certain means-tested benefits who qualify for the 'Travel to Hospital Scheme'. The Isle of Wight Council has for the past two years given limited help to some others who need to travel for health reasons but this burden falls on local council taxpayers.

Residents also need to cross the Solent to access other services not available on the Island and to visit friends and family. This is a particular concern for many of my more elderly constituents and those on low incomes.

It is clear that every resident on the Island represents a captive market for the ferry companies in case of social or other emergency.

It is not only residents of the Isle of Wight who are affected by the ferry services. There are those who live on the mainland and work on the Island and commute daily or less frequently across The Solent, the friends and families of Island residents who wish to visit as well as holidaymakers and day trippers.

The fact that this submission has attracted the support on a cross party basis of Members of Parliament from neighbouring mainland constituencies should be taken into account when considering the number of people who rely on or are affected by the ferry services.

There are only two commercial ferry companies operating for the transport of passengers, private cars and freight vehicles, Red Funnel and Wightlink. A third commercial operator, Hovertravel, operates a passenger-only hovercraft service only between Ryde and Southsea.

Red Funnel and Wightlink do not share terminus facilities. Red Funnel operates as the monopoly supplier of passenger and vehicle transfer from the ports of Cowes and East Cowes linking to Southampton. Wightlink operates a monopoly service from Fishbourne and Yarmouth linking respectively to Portsmouth and Lymington. Hovertravel's terminus facilities are suitable only for use by hovercraft.

In terms of choice, there are cost and routing disadvantages which arise from the exercise of local monopoly in terms of berthing location. In practice neither foot passengers nor vehicle traffic use routes interchangeably as choice of route is primarily determined by journey origin, destination and by public transport links at the various ferry termini.

This submission requests that the Office of Fair Trading (OFT) carry out a market investigation into the ferry services between the Isle of Wight and the mainland and to consider whether there are fundamental problems concerning the operation of these services from a competition standpoint. While the service provided by Hovertravel is important for a number of travellers, the vast majority of the complaints I receive are in relation to the services and prices of the two main operators Red Funnel and Wightlink.

The last meaningful investigation into cross-Solent competition issues was in 1990 with a report published in 1991 (although there was a review with unpublished findings in 2000). There is widespread support on the Island for a full investigation into these issues as evidenced by the cross party and widespread support for this submission, evidence of which is attached.

Of particular relevance to this submission is Article 86 of the Treaty of Rome. I believe that the ferry companies represent undertakings within the meaning of Article 86, which are entrusted with the operation of services of general economic interest and have the character of revenue-producing monopolies.

In particular, these undertakings should not, by their behaviour, affect the development of trade. It is my submission that high monopolistic tariffs have a detrimental effect on the development of trade on the Isle of Wight.

I have also raised the matter of local transport monopolies (as existing on cross-Solent routes) in Parliament with the Secretary of State for Transport. I was advised by him that these concerns should be raised with the OFT. I am grateful for the advice received from Vincent Smith, Head of Competition Enforcement at the OFT who visited the Island to discuss the issues with me and others and gave some guidance on how this submission should be approached.

One of the ferry companies has indicated to me that they would strongly resist any investigation by the competition authorities on the grounds that such an investigation would involve significant resources, both in direct costs and in terms of management time and effort. I believe that view to be directly in conflict with the interests of ferry users. The interests of the average consumer who is not in a position to seek advice from teams of specialist lawyers or expensive consultants should be protected by the competition authorities.

I attach a file of evidence supplied by Island residents, organisations and businesses, business travellers to and from the Island and tourists. I am grateful to them all for taking the trouble to document their experiences of using the ferry services to support this submission to the OFT. This submission should be read in conjunction with the file of evidence and taking into account support from other Members of Parliament as these matters also affect many of their constituents.

I attach also a list of organisations, businesses and individuals who support this submission.

2. Primary Assertions regarding monopoly behaviour by the Ferry Companies

Circumstances both on the Island and in the UK generally have changed considerably since the market was last examined properly in 1991. It is clear, however, that **all** the reasons which justified the original investigation remain extant and on those grounds alone I submit it is time for a full review of the cross-Solent ferry market. The 1991 report explicitly says that there may be a need for further monitoring. In addition the situation has worsened significantly since the last time the OFT briefly examined the market in 2000.

2.1 Debt charges

Both companies have now been sold on (again) with the previous owners reportedly extracting large capital receipts from the sale. The actual sale prices of both companies are a matter of commercial confidentiality but it is known there was considerable uplift over previous sale prices for both operators. The new owners, both major financial institutions (as opposed to ferry operators) – Prudential for Red Funnel and Macquarie Bank for Wightlink are imposing substantial debt charges on Isle of Wight ferry users, indeed debt financing appears to represent the largest of all costs requiring recovery.

Prior to the latest company sale, a basic analysis of the accounts of both companies demonstrates that both Wightlink's and Red Funnel's financial charges represented 38 and 39% of total charges. The position may well have worsened after the latest acquisitions and should be thoroughly investigated. *See Appendix 1*.

Although owned by private operators the two primary suppliers of ferry services are clearly providing an essential public service. The way in which their assets and monopolistic rights have been developed to extract value to the shareholders at the expense of public service obligations is a matter, which I believe warrants proper investigation.

The study by the OFT published in 1991 attempted to establish the return on capital employed (ROCE) a figure arrived at after charging depreciation but before charging interest, in order to ascertain the profitability of the ferry companies in relation to the original investment in the assets employed. They (The OFT) then sought to determine whether that profitability represented a fair level of return.

I submit that the competition authorities should look again to establish the ROCE in order to establish that the ferry companies are not abusing their position in view of the essential nature of the services they provide. It should also be investigated whether the financial structure of the companies has been manipulated in order to maximise income from servicing large debt and/or financing charges which do not directly provide the consumer with benefit.

2.2 Discriminatory pricing and monopolistic behaviour

Turning next to the issue of discriminatory pricing I believe it is clear previous investigations by the OFT have failed to recognise the extent to which monopolistic behaviour is sustained.

In relation to residents' fares, since the acquisition by the Macquarie Bank Wightlink has reduced the time allowed for residents to use bulk purchases of tickets from 12 months to 6 months. For infrequent resident travellers particularly the elderly, this restriction has the affect of negating the discount available from bulk purchase and subtly discriminates against residents, especially those on low or fixed incomes.

This is just one example of pricing practices which I believe cannot be justified on the grounds of efficient discriminatory pricing to better utilise assets. Of particular concern is the fact that my constituents (and Island visitors) regularly report confusion and mispricing of fare tariffs at ticket offices, using telephone booking services and when booking over the internet. It is very difficult to be sure that you are being sold the most cost effective fare suitable for your journey.

Red Funnel does not allow particular discounts to residents for bulk purchase, although some journeys are slightly less expensive if they originate from the Island rather than the mainland.

In general it is widely believed that fares have risen at a much higher rate than inflation over the past ten years. This needs to be carefully investigated. It seems the extraction of capital in the form of re-pricing monopoly profits on the sale of the businesses may have underpinned this situation. Ferry companies regularly point to headline fares and offers which they contend have not risen for a number of years but those are limited in availability and offer significant restrictions on travel.

International comparisons are relevant and I would ask the OFT to take notice of alternative ferry models in any market investigation undertaken. As outlined in my introduction it is important to remember that the Isle of Wight ferry services are 'lifeline services'. There is no other public transport available that enables residents to reach the mainland, freight to reach the Island or tourists to reach their destination.

I have received complaints that reliability and service levels have declined over recent months and it should be investigated whether this perception is accurate. If found to be true competition authorities should consider whether the lack of realistic competition on the routes is a contributory factor and what action could and should be taken to remedy the situation. A number of constituents have raised concerns that safety may have been compromised in some situations.

2.3 Monopoly ownership of port facilities and competition issues

The situation regarding the operation of port facilities is in my view entirely unsatisfactory. In 1991, the statutory harbour authority at Fishbourne was transferred by Harbour Revision Order to Wightlink Ltd. The terminus has, in effect, only one owner but the shipping services using the port are in one and the same ownership. This makes it practically impossible for another shipping/ferry operator to use the port of Fishbourne. Further berthing and storage facilities have already been recommended as part of a report commissioned by the Isle of Wight Council from MVA consulting into cross-Solent movements (June 2006). A policy commission by the Isle of Wight Council has recently looked into how they can work with other stakeholders to upgrade and develop terminus facilities. It is accepted, however that there are unlikely to be opportunities to develop any additional facilities in the short or medium term. Even if a planning application were to be made in the near future it would be years before there were additional facilities. Without any competition, the current operator has no incentive to make the investment necessary and to improve its own competitiveness.

In 1991, at the time of the previous OFT report there was some competition on the Cowes to Southampton route for foot passengers from a new operator Cowes Express, operating from Thetis Wharf in Cowes. This company went out of business however, shortly after the publication of the report. It is widely believed on the Island this was due to predatory pricing by Red Funnel, an accusation the company denies. I understand, however, that Thetis Wharf is the only realistic alternative location from which a passenger service could be operated from Cowes and it is now owned by Red Funnel.

In 1991 there was also a passenger only service running from Portsmouth to West Cowes operated by Red Funnel. This service no longer exists.

In recent years Wightlink has not operated a passenger ferry service from Cowes to Portsmouth during the annual Cowes Week sailing festival as they have done previously. I understand that this is due at least in part to a lack of berthing facilities.

There is little doubt the current ferry operators have effective control over all available port berthing facilities on the Isle of Wight and that the substantial market entry costs coupled with the lack of available port facilities makes it very unlikely that under present conditions there will ever be a new entrant to the cross-Solent market, or at least not in the foreseeable future.

The 1991 report commented that the (then) recent increase in competition may not prove sustainable or develop further. That fear has been borne out and there is now even less competition than there was at the time the market was last examined.

2.4 The provisions of The Enterprise Act 2002

The last time the cross-Solent ferry market was examined in any detail was in 1990 with a further cursory review in 2001. Since that time the Enterprise Act 2002 has come into force which means that the market has never been properly examined under the current legislative framework.

Section 131 of the Act provides that the OFT may make a reference to the Competition Commission if there are reasonable grounds for suspecting that any "feature, or combination of features, of a market in the United Kingdom for goods and services restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom".

Using the OFT's own guidance on their approach to market studies on such matters I submit there are strong grounds to suspect that the market does not work well for cross-Solent ferry users and that action should be taken to remedy the situation.

Using that guidance the following points are relevant:

- The market is highly concentrated with two firms having a very high combined market share.

- I contend that the market shares of the two companies are relatively static. Although there may be minor changes of market share in the various components that make up the entire market, over a number of trading periods there is little change.

- Undoubtedly, there would be very high costs of entry for any new operator and even more significant barriers to entry due to lack of access to berthing facilities, particularly on the Isle of Wight.

- Consumers are unable to easily choose between the suppliers of ferry services due to the constraints of their journey origin, destination and in many cases the availability of suitable public transport to complete the journey to their ultimate destination.

- Ferry users frequently complain that it is difficult to gain access to accurate information about how they can access the most advantageous tariff that meets their requirements from both main operators, whether using booking offices, telephone enquiry services or the internet. It is widely believed on the Island that the terms of trade for both main operators are far from transparent.

- There is a relatively high proportion of elderly and economically disadvantaged residents on the Isle of Wight who suffer severe adverse impacts because of the high ferry prices. There are also significant adverse implications for those who need to cross The Solent for health, education and employment reasons.

- I believe there has been a lack of innovation in the market due largely to the lack of effective competition.

- The degree of variation, or indeed consistency and stability of pricing in the market is impossible for the average user of ferry services to determine. There needs to be a proper market study in order to establish these facts. It seems that both ferry companies often blame price rises on increases in fuel costs. Those claims should be examined closely.

- Gross profit margins (if examined on the basis of return on capital employed) bear little relation to those declared through the companies accounts and should be examined to determine whether they represent a fair yield on the investment in assets.

The cross-Solent market should be examined in comparison with similar services in other EU countries and elsewhere. Proper account should be taken of the essential nature of these services on my constituents. The needs of businesses, both those based on the Isle of Wight and those who seek to do business on the Island must also be taken into account. Of particular concern are businesses dependant upon tourism and others needing regular access to the mainland in order to trade.

Due consideration and weight should be given to the very high number of people who are affected by the cross-Solent ferry market. That number includes not only residents of the Isle of Wight but also people on the mainland who need or wish or need to travel to the Island for any reason.

3. Summary and request for action

Taking account of all the reported circumstances, the OFT should carefully examine the performance of the current ferry operators and seek to negotiate undertakings with them to ensure they take steps to fulfil obligations which they have as ‘essential service’ undertakers. If this does not produce an effective result then the OFT should consult on a market investigation reference to the Competition Commission. Without going into extensive detail the type of undertakings which I and my constituents have in mind are as follows:

- Resident fares to be purchased after current security checks, on a simple discounted tariff basis, fixed as a percentage of the standard tariff.

- Resident fares to be substantially discounted against the standard tariff for bulk purchases.

- Twelve months restored as the basis for residents bulk ticket purchase.

- A special ‘resident plus carer’ tariff to be applied for all outpatient treatment for residents going to mainland hospitals.

- Freight tariffs off peak to be re-assessed to provide higher incentive for freight movers to avoid peak travel.

- All tariff structures to be simplified and internet offers to be discounted from published tariffs.

- A full consultation exercise to be entered into with the tourist industry and the business community to investigate how the ferry services can best meet their needs.

- A price freeze for three years introduced (apart from fuel increases) with no reduction in services to encourage the companies to improve efficiency without any loss of services.

- The separation of harbour authority ownership from the ferry companies to provide an incentive to new ferry entrants.

I request, therefore, that the Office of Fair Trading undertake a formal review of market conditions in regard to the performance of the companies who provide ferry services to the Isle of Wight. The evidence enclosed which has been supplied by my constituents and others gives ample justification for this request.