

23 June 2004

COMPETITION ACT 1998 NOTICE OF NON INFRINGEMENT

Suretrack Rail Services Ltd and P. Way Services Ltd complaint against London Underground Group concerning the supply of safety critical personnel

SUMMARY

1. The Rail Regulator (“the Regulator”) has decided to close his investigation into complaints made under the Competition Act 1998 (“the Act”) by P Way Services Limited (“P Way”) and Suretrack Rail Services Limited (“Suretrack”) regarding the supply of safety critical personnel on the London Underground network. Following investigation of these complaints, the Regulator has concluded that the London Underground Group of companies (“LU Group”), did not breach the Chapter II prohibition of the Act. This document sets out the Regulator’s conclusions following his investigation and also describes the relevant factual background and the conduct of his investigation.

BACKGROUND

Jurisdiction

2. The Regulator is an independent statutory office holder appointed by Government under the Railways Act 1993¹ (“the Railways Act”). The Regulator has a range of statutory powers under the Railway’s Act which include the approval of the contracts between owners of railway facilities (track, stations and light maintenance depots) and those requiring access to those facilities. The Regulator also issues licences (or, if appropriate, licence exemptions) to those wishing to operate railway assets (passenger or freight trains, networks, stations or light maintenance depots). In addition, the Regulator is the competent competition authority, concurrently with the Office of Fair Trading (“OFT”), under the Act with the responsibility for investigating and examining possible breaches of the prohibitions in that Act of (i) anti-competitive agreements (the “Chapter I prohibition”) and (ii) abuses of dominant positions (“the Chapter II prohibition”) which relate to the supply of services relating to railways².

3. The Chapter II Prohibition as defined in Section 18 of the Act provides:

“...any conduct on the part of one or more undertaking which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.”

¹ As amended

² Section 67(3) Railways Act 1993. Section 67(37A) Railways Act 1993 provides that “services relating to railways” means: “railway services” (as defined in section 82 of the Railways Act 1993); the provision or maintenance of rolling stock; the development, maintenance or renewal of a network, station or light maintenance depot; and the development, provision or maintenance of information systems designed wholly or mainly for facilitating the provision of railway services.

4. The Regulator may conduct an investigation only if there are reasonable grounds for suspecting that the Chapter I prohibition or the Chapter II prohibition has been infringed³. This is the legal test (known as the “section 25 test”) that must be satisfied before the Regulator may exercise any of the formal powers of investigation granted to him by the Act. Whether this test is met will depend upon the information available and the judgment of the Regulator⁴. The types of information that will be sources for reasonable grounds for suspicion are wide-ranging but can include documents provided by employees and complaints by third parties⁵.

5. Where the section 25 test has been met, the Regulator may require *any* person to produce to him a specified document or provide him with specified information which he considers relates to any matter relevant to his investigation⁶. The Regulator exercises this power by providing a notice in writing to the person from whom he requires documents or information and he must specify the documents or information required or categories thereof and he may specify a deadline by which such information is to be provided⁷. The Regulator may take copies of documents produced to him in this way and require explanations about documents so produced⁸.

6. The Regulator also has powers, when the section 25 test has been met, to enter premises without a warrant and to require the production of specified documents, explanations of documents and the production of information stored in any electronic form. The Regulator may also enter and search premises with a warrant. Depending on the power being used, the Regulator may take copies of documents or may take the original documents produced to him⁹.

7. It is an offence to fail to comply with formal requests for information, documents, or explanation, or intentionally to obstruct an officer using his powers to enter or search premises. It is also an offence to destroy or falsify relevant documents or to provide false or misleading information¹⁰.

8. When the Regulator has found that the Chapter I or the Chapter II prohibition has been breached, he may direct that the agreement or conduct in question be modified, terminated or

³ Section 25 Competition Act 1998

⁴ OFT guideline 404, “*Powers of Investigation*” paragraph 2.1

⁵ Ibid

⁶ Section 26(1) Competition Act 1998

⁷ Section 26(2) to (5) Competition Act 1998

⁸ Section 26(6) Competition Act 1998

⁹ See sections 27 to 30 Competition Act 1998 and OFT guideline 404, “*Powers of Investigation*” for a more comprehensive description of these powers.

¹⁰ Sections 42 to 44 Competition Act 1998

cease as the case may be and as is appropriate¹¹. The Regulator may also impose a fine on an undertaking for breaching either the Chapter I or Chapter II prohibition which may not exceed 10 per cent of that undertaking's turnover¹².

9. In order to find an infringement of either the Chapter I or Chapter II prohibition, the Regulator must be satisfied that there is strong and compelling evidence of an infringement and must be so satisfied in relation to each element necessary to establish that infringement. This reflects the serious nature of infringements under the Act and the potential penalties that may be imposed for such infringements. In its judgment in *Napp Pharmaceuticals Holdings Limited and subsidiaries v Director General of Fair Trading*, the Competition Appeal Tribunal held as follows:

“Since cases under the Act involving penalties are serious matters, it follows from Re H that strong and convincing evidence will be required before infringements of the Chapter I and Chapter II prohibitions can be found to be proved, even to the civil standard. Indeed, whether we are, in technical terms, applying a civil standard on the basis of strong and convincing evidence, or a criminal standard of beyond reasonable doubt, we think in practice the result is likely to be the same. We find it difficult to imagine, for example, this Tribunal upholding a penalty if there were a reasonable doubt in our minds, or if we were anything less than sure that the Decision was soundly based.

*In those circumstances the conclusion we reach is that, formally speaking, the standard of proof in proceedings under the Act involving penalties is the civil standard of proof, but that standard is to be applied bearing in mind that infringements of the Act are serious matters attracting severe financial penalties. It is for the Director to satisfy us in each case, on the basis of strong and compelling evidence, taking account of the seriousness of what is alleged, that the infringement is duly proved, the undertaking being entitled to the presumption of innocence, and to any reasonable doubt there may be.”*¹³

The complaint

10. On 2 July 2002, the OFT received a complaint from P. Way. The complaint concerned the supply of safety critical personnel (and in particular personnel known as Protection Masters) on the London Underground network. The OFT received a similar complaint from Suretrack on 9 July 2002.

11. As the complaints concerned the supply of services relating to railways, the OFT, in accordance the Competition Act 1998 (Concurrency) Regulations 2000 (SI 2000/260), drew these complaints to the attention of the Regulator. It was consequently agreed between the OFT and the Regulator that these particular complaints would be investigated by the Regulator.

¹¹ Sections 32 and 33 Competition Act 1998

¹² Section 36 Competition Act 1998. See also OFT guideline 407 “Enforcement” and OFT guideline 423 “Guidance as to the appropriate amount of a penalty”

¹³ *Napp Pharmaceuticals Holdings Limited and subsidiaries v Director General of Fair Trading* - Case 100/1/01 [2002] CAT 5 paragraphs 108 to 109.

12. Both complainants alleged that a policy (the “approved supplier policy”) implemented by London Underground Limited (“LUL”) and its then subsidiaries Infraco JNP Limited, Infraco BCV Limited and Infraco Sub-Surface Limited (the “Infracos”) regarding the supply of safety critical personnel working on the London Underground network was anti-competitive. In broad terms, the policy required contractors performing maintenance or engineering works on the LU network which required the presence of safety critical personnel to procure such personnel solely from suppliers approved by the three Infracos or to use appropriate personnel directly employed by themselves. The policy in effect prevented contractors from using P.Way and Suretrack personnel because these companies were not Infraco-approved suppliers of safety critical personnel.

Public Private Partnership (PPP) for the London Underground - relevance to the complaint

13. The PPP for the underground was announced on 20 March 2000. In broad terms, under the PPP arrangements, responsibility for the maintenance and enhancement of all of the London Underground network’s infrastructure was transferred to private sector companies, whilst operation of passenger services themselves remains with the publicly owned company, LUL.

14. The first step towards establishing the PPP was the incorporation of three infrastructure companies, Infraco JNP Limited, Infraco BCV Limited and Infraco Sub-Surface Lines Limited (together “the Infracos”) as wholly-owned subsidiaries of LUL. In broad terms, each Infraco was given responsibility for the maintenance, renewal and enhancement of all of the infrastructure (track, signalling, rolling stock, stations etc.) relating to particular lines on the London Underground network. Part of the mechanism for the transfer of these responsibilities to the Infracos was the leasing of the relevant infrastructure assets to them by LUL on long leases, together with the transfer of relevant personnel.

15. As a precursor to the transfer of their respective businesses to the private sector, the three Infracos were operated on a “shadow running” basis. The aim of “shadow running” was to test the new organisational arrangements and to ensure that the PPP contracts would work in practice. The PPP contracts are between each Infraco and LUL. Each PPP contract is for duration of 30 years and provides for the payment of a four-weekly “Infrastructure Service Charge” by LUL to each Infraco. In return for this charge the Infracos, are required to make significant investments in the maintenance and renewal of the network infrastructure.

16. Bidders were invited from the private sector to tender for the right to take ownership of the Infracos. On 31 December 2002, Infraco JNP (now called Tube Lines Limited) transferred to Tube Lines (Holdings) Limited, owned by a private sector consortium of Bechtel, Jarvis and Amey. Infraco SSL (now called Metronet Rail SSL Limited) and Infraco BCV (now called Metronet Rail BCV Limited) are now owned by Metronet Rail Ltd , which itself is owned by a private sector consortium of Balfour Beatty, WS Atkins, Bombardier Transportation, Thames Water and Seeboard.

The main parties

London Underground Limited (LUL):

17. Until 15 July 2003, LUL was a wholly-owned subsidiary of London Regional Transport (“LRT”) which was under the direct control of the Department for Transport. On 16 July 2003, ownership of LUL transferred to Transport for London (“TfL”) which is itself directed by the Mayor of London. LUL operates passenger services on the London underground railway network and for the year ending 31 March 2002, it had a turnover of £1,251million.

The Infracos

18. As described above, at the time of the complaint, the Infracos were all wholly-owned subsidiaries of LUL. The Infracos (now privately owned) are responsible for the maintenance, renewal and enhancement of the infrastructure of the London Underground network – this includes rolling stock, stations, track, signalling systems, escalators, tunnels, bridges and embankments.

19. Tube Lines Limited (formerly Infraco JNP Limited) is responsible for the Jubilee, Northern and Piccadilly lines; Metronet Rail BCV Limited (formerly Infraco BCV Limited) is responsible for the Bakerloo, Central, Victoria and Waterloo & City lines; Metronet Rail SSL Limited (formerly Infraco Sub-Surface Limited) is responsible for the Circle, District, Metropolitan, Hammersmith & City and East London Line.

The complainants

P. Way Services Limited

20. P. Way was incorporated in September 1996. Its business is the supply of safety critical personnel to Contractors performing maintenance and engineering works on the London Underground network. The safety critical personnel it supplies are either directly employed by P.Way or contracted to the customer in which case the individual is self-employed.

Suretrack Rail Services Limited

21. Suretrack was incorporated in June 2001. Its business is the same as that of P.Way Ltd – ie the supply of safety critical personnel to Contractors performing maintenance and engineering works on the London Underground network. The safety critical personnel supplied by Suretrack are either directly employed by Suretrack or self-employed contractors.

The role of safety critical personnel

22. Safety critical personnel are required when maintenance and/or engineering work is carried out on or near the track, for example, to ensure that track is not live, and safe working practices are followed in a potentially hazardous environment. It is therefore the organisations that carry out such engineering work (which can be the Infracos themselves or other undertakings contracted to carry out the relevant works) that require the services of safety critical personnel to ensure that work is carried out safely.

23. There are four main categories of safety critical personnel working on the London Underground; Protection Masters; Train Masters; Possession Masters and Cable Linemen. Of these four categories the complaints focussed on Protection Masters. Protection Masters provide protection to the personnel working on or near the track. They are there to ensure that the section of track being worked on is safe. The Protection Master's duties include:

- (a) ensuring that there are no trains running on the track;
- (b) ensuring that the current has been switched off;
- (c) ensuring that there are no impediments on the track;
- (d) putting in place a safe system of work for the shift;
- (e) preparing and delivering a safety briefing to all workers;
- (f) arranging protection for workers accessing tracks during engineering and traffic hours;
- (g) checking all workers are in satisfactory condition to work
- (h) undertaking PPE (Personal Protective Equipment) checks, to ascertain that each worker has the necessary equipment for the work in question.

24. LUL's standards determine the following:

- (a) deciding what the duties and responsibilities of each category of safety critical personnel are; and
- (b) deciding what qualifications and training are needed for a person to work in any of the categories of safety critical operative (this includes requirements in respect of drugs and alcohol testing and determining how often training and qualifications have to be renewed).

25. The Compliance and Licensing Office ("CLO") monitors whether the qualification, training and testing requirements are complied with in respect of all safety critical personnel who work on the London Underground network. To carry out this function, the CLO issues all safety personnel with an Internal Verification (IV) number. A safety critical operative requires a valid IV number in order to carry out his/her duties. In order to gain access to the track infrastructure for the purpose of carrying out his/her duties the safety critical operative must present a valid IV number to the Track Access Controller. If a valid number is not presented track access will not be granted. The CLO will invalidate an IV number where the safety critical operative's qualifications and training are not up to date, if drugs or alcohol tests have been failed or if it has been found that duties have not been carried out to the required standard.

The approved supplier policy

26. As described above, safety critical personnel are required when engineering and/or maintenance works are being carried out on or near the track. Therefore, it is those who carry out such maintenance and engineering works who require the services of safety critical

personnel to ensure that these works are carried out safely. The vast majority of maintenance and engineering works on the London Underground network is carried out by contractors, who have contracted with LUL or the Infracos to carry out the particular works in question.

27. Although contractors generally have the direct need for safety critical personnel, LUL (and subsequently the Infracos) have historically provided a large proportion of such personnel to contractors, whether by providing LUL/the Infracos directly employed personnel or personnel supplied to it by third party agents.

28. In 1999, LUL decided to put the supply to LUL of safety critical personnel out to tender. This tender process foresaw and was designed to accommodate the PPP process. LUL sent pre-qualification questionnaires to all known suppliers of safety critical personnel in June 1999. The responses to these questionnaires were subsequently evaluated and shortlisted companies were invited to tender for the contract. Invitations to tender were issued on 2 June 2000 with a deadline for responses of 30 June 2000. Tenders were received from all shortlisted companies. The tenders were then evaluated and in January 2001 contracts were awarded to three companies: Finchpalm Limited, Morson Human Resources Limited and Cleshar Contract Services Limited (the “Approved Agencies”).

29. Until 2002, contractors performing maintenance and engineering works on the LU network had in practice been able to choose whether to obtain safety critical operative services from LUL/the Infracos or purchase such services from independent third party suppliers.

30. In May 2002, the Infracos gave notice to all their contractors that they would no longer be able to purchase safety critical services from independent third party suppliers. Contractors would only be able to book these personnel through the appropriate Infraco booking desks and therefore only the approved contractors engaged on long term contracts with LUL/the Infracos would be used to supply safety critical personnel¹⁴. Alternatively, Contractors could use safety critical personnel who were directly employed by them (self supply). The approved supplier policy was due to be effective on 22 June 2002. The effect of this was that the Approved Agencies, via their contracts with the Infracos, became the only undertakings who could supply safety critical personnel to contractors.

Quensh condition 5.39

31. The notice to contractors informing them of the new policy, was stated by the Infracos to be in accordance with “QUENSH condition 5.39”.

¹⁴ The general arrangements put in place were that contractors performing works on the London Underground network that required safety critical personnel were to book such personnel through an Infraco booking desk. The Infracos would then invoice contractors for the supply of these personnel (although the exact nature of the invoicing arrangements would depend on the details of the contract between the Infraco and the contractor which varied from one to another). The Infracos would themselves be invoiced for the supply of safety critical personnel by the Approved Agencies in accordance with the terms of their contracts.

32. QUENSH (Quality, Environmental, Safety and Health) is a body of rules which ensures that all goods and services on the London Underground network are procured and managed in a safe and environmentally sensitive manner with an acceptable standard of workmanship. The regulations apply to both LUL and Infraco employees as well as any Contractors. The rules were designed and implemented by LUL to ensure that uniform conditions for contracts exist, encompassing both legislation and the wider aims of LUL. As custodian of QUENSH, LUL maintains overall authority to monitor and ensure compliance with its requirements; this is done through a system of audits and 'on site' checks.

33. The Infracos are obliged under their respective PPP contracts (clause 9) and the Standards code to comply with all Category 1 Standards. QUENSH in its entirety is a Category 1 Standard. The Standards are mandatory in respect of all work and the procurement of goods or materials leading to or resulting in "on-site" inspection, construction, building, maintenance and cleaning - i.e. this includes all safety critical work. Category 1 Standards are controlled by LUL and amendments may only be made with the express consent of LUL. All the Infracos took responsibility for the implementation of QUENSH from the commencement of shadow running.

34. Because the Infracos have been given responsibility for the implementation of QUENSH, it should be noted that non-compliance with a Category 1 Standard is a breach of the PPP contract. In the event of breach, LUL may issue a Corrective Action Notice ("CAN") specifying the nature of the fault and requiring it to be remedied within a particular time. Failure to remedy a CAN may lead to the issue of a Warning Notice. Failure to remedy the circumstances giving rise to a Warning Notice may result in the suspension of the Infraco's performance of the service to be provided under the PPP contract. Additionally or alternatively, it could also lead to the mandatory transfer of the Infracos' property, rights and liabilities under the contracts to a third party. LUL also has step-in rights (either to deal with a single breach or to take over the whole contract) as a remedy for breach. It may subsequently step-out and charge the relevant Infraco any costs incurred.

35. QUENSH condition 5.39 (Revision 11) read as follows:

5.39 Use of External Safety Critical Personnel

(a) *Application of Service Provision Framework - The application of this framework is mandatory and places a duty of compliance on all parties involved, both internal and external. This Service Provision Framework specifies London Underground's requirements for the external sourcing, supply and use of personnel to perform the safety critical activities listed below:*

(i) *Protection Masters*

(ii) *Train Masters*

(iii) *Possession Masters*

(iv) *Cable Linemen*

(b) *Source of Supply - The provision of these activities shall only be obtained from one of the following sources:*

- (i) *Licensed LUL employed staff*
- (ii) *Critical Resource Agency (CRA)*
- (iii) *Approved Contractors - (see note below)*

Note: Contractors supplying these services must have been approved by the CRA and be engaged on long term contracts with LUL. Personnel supplied to undertake the safety critical activities, shall be either directly employed by the contractor, or self employed and shall only be used on that particular contractor's work sites.

- (c) *Subcontractors - All contractors to London Underground and other parties working on the rail system, shall only engage personnel from one of the above three sources. The use of any other supplier or subcontractor for the provision of any of these safety critical activities is strictly forbidden and may lead to disqualification of the main contractor."*

36. The Infracos, led by Infraco JNP Limited, adopted a policy that the reference to "Approved Contractors" in paragraph (b)(iii) of QUENSH Condition 5.39, when read together with the accompanying note, was to be interpreted as referring only to those suppliers of safety critical personnel with whom LUL had directly contracted for the supply of such personnel through the tender process described above. Therefore, Contractors performing maintenance and other works on the London Underground network that required the use of safety critical personnel would not be allowed to make their own arrangements with third party suppliers of such personnel (such as the complainants). As the May 2002 notice made clear, when not using their own employees, Contractors had to book their safety critical personnel requirements centrally with the Infracos and they would then be supplied with the personnel from the Approved Agencies.

THE REGULATOR'S INVESTIGATION

Interim Measures

37. The complainants both requested that the Rail Regulator exercise his power under section 35(2) of the Act to impose interim measures requiring LUL and the Infracos to cease the behaviour which was the subject matter of the complaint in order to prevent serious and irreparable damage to them. Formal requests for interim measures were made by Suretrack and P. Way respectively on 19 and 26 July 2002.

38. The Regulator may give directions for interim measures if he has a reasonable suspicion of infringement of either the 'Chapter I prohibition' or the 'Chapter II prohibition' of the Act¹⁵ and if he considers it necessary to act as a matter of urgency to prevent serious, irreparable damage to a particular person or category of person, or to protect the public interest¹⁶.

¹⁵ See section 35(1).

¹⁶ See section 35(2).

39. On the basis of the facts then available to him, the Regulator considered that there were sufficient grounds for him to have reasonable suspicion of infringement of Chapter I and/or Chapter II. He also considered it necessary to act as a matter of urgency to prevent serious irreparable damage to particular persons, namely P.Way and Suretrack, before completing his investigation. LUL and the Infracos made representations to the Regulator that interim measures should not be imposed.

40. The Regulator considered those representations but remained of the view that he had reasonable grounds to suspect that the new approved supplier policy infringed the Act. The Regulator was also satisfied that, after examining evidence supplied by the complainants, the new policy being applied by the LU Group could have caused serious, irreparable damage to them.

41. The Regulator's notice proposing to issue interim measures directions dated 7 August 2002 required the LU Group to stop prohibiting their contractors from sourcing the supply of Protection Masters other than from approved sources and, secondly, to stop preventing Protection Masters on the books of agency suppliers other than those approved by the Infracos from accessing training facilities and from obtaining training materials.

42. On 16 August 2002, the LU Group gave assurances to the Regulator. The assurances resulted in reinstatement of excluded suppliers of safety critical personnel on a temporary basis. LU Group would then undertake a full safety audit of the temporarily approved suppliers - the audit criteria for which would be subject to review by the Regulator. The Infracos assured the Regulator that they would not prevent contractors from sourcing Protection Masters from such agencies unless either the Infracos considered that a bar would be necessary for safety reasons, or the agency in question failed to meet the necessary standard in the qualifying safety audit.

43. Contractors were notified of the assurances by way of a letter and through the publication of the same in two trade journals (the wording of which was agreed by the Regulator). In the light of these assurances it was not ultimately necessary for the Regulator to issue interim measures directions.

44. As part of evaluating the assurances received from the LU Group in lieu of interim measures, the Regulator commissioned and received an independent review (by a firm of safety consultants) of the safety audit criteria proposed by LU Group. The consultants were asked to consider whether the audit checklists proposed by the LU Group were fair, objective and proportionate to the size and scope of organizations providing Protection Master services. The consultant's report stated that in general the audit checklists provided a good set of objective questions. In the consultant's opinion, to pass these audits an organisation would need good safety management policies and safety-conscious management.

Information Gathering

45. Between September and December 2002, the Regulator sent a series of notices under section 26 of the Act requiring the production of information and the answering of questions in order to assist him with his investigation. Notices were sent to suppliers of safety critical personnel (including the complainants and "approved agencies"), contractors performing works on the London Underground network, and the companies in the LU Group.

46. The Regulator also sought information to ascertain the effect of the implementation of Quensh condition 5.39; information about the nature of a Protection Master's duties and training; information about the nature of the supply of safety critical personnel services to those requiring them; details of PPP contractual arrangements; and information to explain payment flows between contractors, Infracos and LUL.

ASSESSMENT

Relevant Market and Dominance

47. In order for there to be an infringement of section 18 of the Act, the Regulator must define a relevant market; establish that the undertaking(s) concerned has a dominant position in that relevant market and establish that that undertaking(s) has abused that dominant position. He must further establish that the relevant conduct "*may affect trade within the United Kingdom*". However, given the Regulator's findings (detailed below) it has not been necessary for him to come to a conclusion on the definition of the relevant market or whether LU Group holds or held a dominant position in such a market.

Assessment of conduct

48. The Regulator does not consider on the evidence available to him that he is able to establish to the required standard of proof¹⁷, that the LU Group's conduct, in implementing the approved supplier policy amounted to an abuse within the meaning of the Chapter II prohibition.

49. The OFT's Guideline "*The Chapter II Prohibition*" states (at paragraph 4.2) that:

"Conduct may be abusive when, through the effects of conduct on the competitive process, it adversely affects consumers directly...or indirectly."

The same Guideline also states (at paragraph 4.3) that:

"...conduct for which there is an objective justification is not regarded as an abuse even if it does restrict competition. For example the refusal to supply a customer may be justified by the poor credit worthiness of the customer."

50. The European Court of Justice has given examples of objective justifications for conduct that might otherwise have been in breach of Article 82 of the EC Treaty on several occasions. (The Chapter II prohibition is based on Article 82 and its application must be consistent with the application of Article 82 by the European Court of Justice.¹⁸) For example, it has held that the tying of two products by a dominant firm could be justified by technical requirements of the products in question.¹⁹ Volume discounts which reflect cost

¹⁷ As set out in the *Napp Pharmaceuticals* judgment discussed above

¹⁸ See section 60 Competition Act 1998

¹⁹ Case 311/84 *Centre Belge d'Etudes de March* "Te'le'marketing v CLT" [1985] ECR 3261, [1986] 2 CMLR 558

savings may also be objectively justified.²⁰ There is a further principle of proportionality to be considered when looking at the question of objective justification which is that the measures taken should not exceed what is required to attain their legitimate objective.

51. As a general rule, customers are able to choose freely those from whom they purchase goods and services and it is a normal part of ordinary commerce that customers make known their preferences for the goods and services they wish to purchase and suppliers have the opportunity to satisfy those preferences. In this regard, the Regulator notes that the LU Group undertook and undertakes competitive tendering processes for the supply of safety critical personnel to it and for the supply of maintenance and engineering services generally in which it specifies the characteristics of the services it wishes to purchase.

52. The Regulator has considered whether the Infracos could have leveraged any potential buyer power they may have and may have had in the purchase of maintenance services to create market power in the supply of safety critical personnel to maintenance contractors in such a way that would adversely affect consumers in downstream markets. In order to examine this potential effect, the supply chain in question needs to be identified.

53. The Infracos operate as infrastructure providers to LUL and LUL in turn acts as a provider of passenger services.²¹ If the Infracos could successfully create market power in the supply of safety critical personnel to maintenance contractors²², they could raise the charges for such services and ultimately seek to pass-on these increased charges to LUL. In turn, LUL would be expected to pass-on (at least to some extent) this increase in charges to consumers (ie passengers) thereby resulting in a potential adverse effect on the latter.

54. The mechanism by which such adverse effects might potentially arise now needs to be considered. To the extent that the Infracos (as part of LU Group) imposed a condition on contractors that they source safety critical personnel from suppliers approved by LU Group (with the Infracos acting as an intermediary “reseller” – see above for a more detailed explanation of this role played by the Infracos in implementing the Approved Supplier policy), this can be characterized as a tying condition. If it could be shown that the Infracos were/are dominant in the purchase of track maintenance services this tying condition might allow them to create market power as suppliers of safety critical personnel to maintenance contractors. The Infracos could then use such market power to raise the charges for safety critical personnel to contractors to a level in excess of the charges to them by the Approved Agencies for the supply of such personnel thereby creating a profit margin on this transaction. However, because this would raise the cost-base for maintenance contractors, such contractors would be expected to pass on this increase in charges to their own customers (ie back to the

²⁰ BPB Industries OJ [1989] L 10/50 upheld an appeal to the Court of First Instance (Case T-65/89 BPB Industries plc and British Gypsum v Commission) and on further appeal to the European Court of Justice (Case C-316/93).

²¹ It should be noted that the Regulator has not needed to conclude on the definition of the relevant downstream markets, for example whether underground passenger services are in the same relevant market as bus or over-ground rail travel.

²² It should be noted that the Regulator has not needed to come to a final view on whether such a market could be defined – in particular, whether a hypothetical monopolist of safety critical personnel to contractors on a contractual basis would be constrained by such contractors directly employing safety critical personnel.

Infracos or LUL) either in the short-term or longer term, depending on the nature of their contracts. As a result, this tying strategy would only be worthwhile from the Infracos' perspective (i.e. in the sense of their being able to retain some or all of the "artificially" created margin described above) if they could in turn pass on (at least some) of this apparent increase in their own costs to LUL. LUL could in turn be expected to pass on, at least to some extent, this increase in charges to consumers.

55. Therefore, from an economic perspective, in order for the above conduct and potential adverse effects on consumers to materialise, strong and compelling evidence of each of the following conditions would need to be demonstrated:

- (a) the Infracos were/are dominant in the purchase of maintenance services (or in some similar market). In particular, such buyer power would need to be durable, i.e. it must be the case that it could not be undermined in the short-term or long-term;
- (b) the feasibility of leveraging such buyer power to gain market power in the supply of safety critical personnel to maintenance contractors²³; and
- (c) the ability to pass increases in charges through the supply chain and ultimately to consumers. (As explained above, the Infracos might attempt to impose a tying condition on contractors in such a way as to artificially generate upward pressure on their own costs and attempt to pass this on to LUL. LUL could in turn be expected to pass on at least some of this increase to consumers.)

56. The evidence obtained by the Regulator has not been sufficiently strong or compelling to conclude that each of these conditions existed in practice. In particular, there does not appear to be a mechanism for any increase in charges for safety critical personnel to be passed-on to LUL and ultimately consumers. First, the PPP contract requires the Infracos to provide a specified amount of protection services to PFI contractors contracted to LUL at no cost to LUL over and above the agreed PPP contract price. In this context, the PPP contract provides a cap on the charge for protection services that the Infracos can pass-on to LUL.

57. Second, the PPP contract is output based²⁴ and Infracos are required to deliver this output in return for payment of the infrastructure service charge which is adjusted on the basis of contract performance. This removes the incentive for the Infracos to raise charges for the supply of safety critical personnel to contractors when such contractors supply maintenance services to the Infracos. The reason for this is that if the Infracos were to increase the charges for the provision of protection services, this would restrict the amount contractors would be willing to purchase and thus reduce the quantity of track maintenance and renewal services

²³ It should be noted that this would require the supply of safety critical personnel to maintenance contractors to be a distinct economic market

²⁴ The PPP contracts define three primary output performance measures: availability (day-to-day service reliability); capability (a measure of the potential capacity of the assets ultimately to reduce journey time); and ambience (a measure of the quality of the travelling environment). For further details see the TfL publication *London Underground and the PPP, The first year 2003/04* at <http://tube.tfl.gov.uk/content/about/report/ppp-report-lu2003-04.pdf>.

that contractors would be willing to deliver to the Infracos for a given contract price.²⁵ Such a reduction would jeopardise the Infracos' ability to meet their output obligations under the PPP contracts with resultant financial penalties under those contracts.

58. Third, LUL does not have the power to alter unilaterally fares on the London Underground. As explained above, LUL is now a wholly-owned subsidiary of TfL. Section 173(2)(c) of the Greater London Authority Act 1999 ("GLAA 1999") gives TfL the power to control fares in any agreement it enters into for the provision of public passenger transport services (such as its agreement with LUL for the provision of London Underground services). The combined effect of sections 155(1) and section 174(1) of the GLAA 1999 gives the Mayor of London the power to give TfL directions as to the general level and structure of fares charged for public passenger transport services provided pursuant to any agreement entered into by TfL. Section 154(3) of the GLAA 1999 places a general duty on TfL to exercise its functions in accordance with any directions given to it by the Mayor under section 155(1) and also to exercise those functions for the purpose of the discharge of the Mayor's duties provided by section 141(1) GLAA 1999. This duty requires the Mayor to develop and implement policies for the promotion of safe, integrated, efficient and economic transport facilities to, from and within Greater London. Therefore, the level and structure of fares on the London Underground is regulated and as a result the ability of LUL to exercise any market power it may have as a supplier or to pass-on inefficiently incurred costs is constrained, although it should be noted that fares are set by TfL in consultation with LUL. In addition, TfL's Annual Business Plan and Budget sets the overall context for service levels and structures. Within these parameters LUL sets and adjusts service levels.

Objective justification

59. The LU Group argued in its submissions to the Regulator during the investigation that its reason for implementing the approved supplier policy was to ensure safety on the London Underground network.

60. While the Regulator notes that through the implementation of QUENSH 5.39 the number of suppliers of Safety Critical Personnel was likely to decrease, he believes that the operation of an approved supplier policy based on safety grounds is objectively justifiable in principle, in particular when considered from the wider perspective of maintaining safety on the London Underground network.

61. The Regulator notes that LUL is a designated "infrastructure controller" under the Railways (Safety Case) Regulations 2000. As an infrastructure controller, LUL has a statutory obligation to prepare a safety case in respect of the London Underground network which has to be accepted by the Health and Safety Executive. This safety case must demonstrate how the relevant infrastructure controller intends to ensure compliance with all its obligations regarding health and safety.

²⁵ Alternatively, for a given maintenance output required by an Infraco from a contractor, any increase in charges for the provision of protection services would raise the cost-base of the contractor, which would be expected to pass-on this increase to the Infraco either in the short-term or longer-term, as noted previously.

62. In considering the approved supplier policy in the context of safety, the Regulator has in particular considered Lord Cullen's report: "the Ladbroke Grove Rail Inquiry (part 2)" commissioned by the Health and Safety Commission. The report highlighted failings as regards:

- (a) the practice of awarding contracts without due regard to the appropriate level of training and preparation of the contracted workforce;
- (b) controls for the management of work of contractors and sub-contractors ;
- (c) the manner in which the employees of contractors and subcontractors are controlled.

63. In particular, the Cullen report also explicitly recommended that steps be taken to reduce the number of sub-contractors in order to improve safety and that greater control be exercised over contractors and sub-contractors' work and employees.

64. In this regard, the Regulator notes that LUL's prequalification exercise for the supply of safety critical resources which resulted in the approved supplier shortlist placed a heavy emphasis on evaluating agency suppliers' safety procedures, competence (including training and the recording and updating of such training), resources (including management organisation and audited document trails) and quality (including adherence to QUENSH). The criteria noted above accounted for 70% of the total weighted evaluation score. The Regulator considers that such criteria directly attempted to address the failings highlighted by Lord Cullen and described above that were considered by Lord Cullen to contribute to inadequate standards of safety.

CONCLUSION

65. The Regulator's investigation has not revealed strong and compelling evidence that the approved supplier policy had an adverse effect on competition and harmed consumers. However, even if such competition effects could be demonstrated, the Regulator has concluded that the imposition of the approved supplier policy can be objectively justified on the grounds of safety and LU Group's audit checklist was fair and objective in this regard.

66. The Regulator has therefore decided that the LU Group has not breached the Chapter II Prohibition.

SARAH STRAIGHT

DEPUTY DIRECTOR

OFFICE OF THE RAIL REGULATOR

23 JUNE 2004