

# Isle of Wight Ferry Services

Market study findings and consultation on proposed decision

June 2009

OFT1096

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## CONTENTS

<i>Chapter</i>	<i>Page</i>
1 Executive Summary	4
2 Introduction	7
3 Background information	10
4 Competition between operators	21
5 Prospects for new entry	31
6 Performance indicators	45
7 Proposed decision on market investigation reference	82
8 Next steps and consultation questions	93

Note: [...]

This report has been edited for publication in accordance with Part 9 of the Enterprise Act 2002. Among other things, this Part requires that the Office of Fair Trading has regard to the need for excluding from the published report, so far as practicable, commercial information whose disclosure it thinks might significantly harm the legitimate business interests of the undertaking to which it relates.

# 1 EXECUTIVE SUMMARY

- 1.1 Last year, Andrew Turner, MP, submitted a complaint, supported by some 8,000 signatures, about ferry services to and from the Isle of Wight<sup>1</sup>, and called for the matter to be referred to the Competition Commission. In February 2009 the OFT launched a market study into the Isle of Wight ferry services with a view to exploring whether the services worked well for consumers and deciding whether to make a market investigation reference (MIR) to the Competition Commission.
- 1.2 The complaint raised the following points of concern:
- there was a lack of competition between ferry operators which was accentuated by high barriers to entry
  - prices were too high
  - the quality of service was declining
  - the companies involved were making very high profits
  - the ownership and financing arrangements of the companies were predicated on significant future increases in prices and profitability.

## Findings of the market study

- 1.3 Competition between the operators appears limited. In most cases, passengers who wish to travel on a particular route have no choice of operator, so competition is limited to those willing to switch routes. Historically Wightlink has enjoyed a strong position in the market. However, Red Funnel (and on a smaller scale, Hovertravel) have gained market share over time, so may represent a stronger competitive constraint on Wightlink now than has been the case in the past.

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<sup>1</sup> The complaint did not include a complaint about Hovertravel. However, our market study included Hovertravel and, for simplicity, the term 'ferry services' in this report includes both hovercraft and boat services unless otherwise stated.

- 1.4 The prospects for new entry into the market appear slim, particularly for vehicle ferries. There are high physical barriers to entry in that existing port facilities on the island are operating close to capacity and there are no firm prospects of new port facilities being built. It is not clear that the routes could sustain more than one operator in any case.
- 1.5 Prices may at times be higher than those of cross Channel ferries but are not obviously out of line with other commercial ferry services across Europe. Average prices for passengers with cars have risen by less than inflation in recent years, though prices for foot passengers have risen a little more sharply.
- 1.6 However, some island residents may have experienced steeper price increases as a result of a shift towards yield-management pricing, whereby lower prices are available to those who are flexible about when they travel and who book in advance. For this reason, island residents accustomed to using the ferry on a 'turn up and go' basis may have experienced higher than average price increases in recent years. While they may question whether yield-management pricing is appropriate for an essential service, it is not, on the face of it, suggestive of competition problems. We note also that the ferry companies continue to offer a range of beneficial discounts to island residents.
- 1.7 Overall, the service appears fairly comprehensive - a scheduled crossing leaves the Isle of Wight every eight minutes or so throughout the day and services run through the night. There is a good level of service all year round. The frequency of services has increased significantly over the last two decades or so, though it has come down slightly in recent years. Overall capacity on cross Solent routes has increased. Reliability is fairly good, with less than one percent of sailings cancelled on most routes. There have been problems with punctuality on one route recently but we have not seen evidence of any long-term trend decline in punctuality. Despite a broadly reassuring picture on these measures of service quality, however, the evidence on customer satisfaction suggests there is room for improvement.

1.8 The evidence on profitability indicates that Wightlink has made substantial profits in the past but that profitability has declined in recent years. The other operators are less profitable.

### Provisional conclusion

1.9 We are now consulting on our provisional decision not to refer the Isle of Wight ferry services to the Competition Commission at the present time.

1.10 This provisional decision has been taken on the basis that, while we have reasonable grounds for suspecting that there exist features of the market that prevent, restrict or distort competition, there is limited evidence of actual consumer detriment.<sup>2</sup> Looking at the evidence in the round, we do not believe that it would be appropriate to make an MIR at this time.

1.11 It is important to stress that the fact that the OFT is minded to decide not to make an MIR on this occasion does not constrain it from further examination of the market in future if presented with cogent evidence that such further examination is warranted.

1.12 We also believe that the ferry companies and Isle of Wight residents alike would benefit from greater transparency about price trends and quality of service. This would allow the operators to demonstrate to the island residents that they care about monitoring and improving services and allow consumers to make an objective assessment of the services they receive.

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<sup>2</sup> The full legal test is set out at chapter 7 together with an assessment of the evidence.

## 2 INTRODUCTION

2.1 Last year, Andrew Turner, MP, submitted a complaint,<sup>3</sup> supported by some 8,000 signatures, about ferry services to and from the Isle of Wight.<sup>4</sup>

2.2 The complaint raised the following principal points of concern:

- there was a lack of competition between ferry operators which was accentuated by high barriers to entry
- prices were too high
- the quality of service was declining
- the companies involved were making very high profits
- the ownership and financing arrangements of the companies were predicated on significant future increases in prices and profitability.

2.3 Andrew Turner, MP, specifically requested that the OFT refer the market for Isle of Wight ferry services to the Competition Commission for an in-depth market investigation.

2.4 In order to make an MIR under section 131 of the Enterprise Act 2002 (EA02), the OFT must have reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, 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. Where this threshold is met, the OFT has discretion as to whether or not to make an MIR.

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<sup>3</sup> See [islandmp.org/oft\\_request\\_summary.php](http://islandmp.org/oft_request_summary.php)

<sup>4</sup> The complaint did not include a complaint about Hovertravel.

- 2.5 In February 2009, the OFT launched a market study into the Isle of Wight Ferry Services with a view to exploring whether the services worked well for consumers and principally deciding whether it could and should make an MIR.
- 2.6 Following the launch of the study, we have received further submissions, most notably from and through Andrew Turner, MP, the three operators, and various other stakeholders. We have sent information requests to the operators and have received detailed responses. We have met with Andrew Turner MP, the three operators and other key stakeholders on the Isle of Wight.
- 2.7 Our aim was to assess whether ferry services operating between the Isle of Wight and the UK mainland work well for consumers. The range of issues we have considered includes the extent of competition between existing ferry operators, the potential for new entry, and outcomes for consumers in terms of prices and quality of service.
- 2.8 The purpose of this report is to set out our findings, to explain the reasons for them, and to consult with stakeholders on the way forward. The report is structured as follows:
- Chapter 3 provides some background information on the Isle of Wight ferry services
  - Chapter 4 presents our findings on the extent of competition between existing operators
  - Chapter 5 presents our findings on the prospects for new entry, covering barriers to entry and the potential for the ferry routes to support multiple operators
  - Chapter 6 presents our findings on indicators of how well the market is working, covering prices, quality of service, and profitability. It also addresses the issues around ownership and financing arrangements
  - Chapter 7 presents the OFT's proposed decision

- Chapter 8 outlines next steps and questions for consultation.

2.9 Finally, we would like to thank all those who have made submissions to us, spent time with us and answered our questions.

### 3 BACKGROUND INFORMATION

3.1 This Chapter presents some background information about the ferry services and the context in which we have conducted the market study. It covers:

- an overview of ferry services to the Isle of Wight
- routes and operators
- ownership of the port facilities
- ownership of the ferry operators
- previous competition investigations into the market.

#### Overview

3.2 The Isle of Wight has a population of about 140,000.<sup>5</sup> The two major population centres are Newport and Ryde.<sup>6</sup> There is no bridge or tunnel nor are there any scheduled air services to and from the Isle of Wight.

3.3 The Isle of Wight is a popular UK tourist destination.<sup>7</sup> The island's favourable climate and relative proximity to major population centres on the mainland make it more popular for tourism which plays an important role in the Isle of Wight economy. It generates some £352 million expenditure per year which represents 24 per cent of the island's GDP and supports one in four jobs.<sup>8</sup>

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<sup>5</sup> See, for instance, Office for National Statistics (ONS) Mid Year Estimates, 2006

<sup>6</sup> See [www.islandgames.net/cms/member\\_profile\\_12368.html](http://www.islandgames.net/cms/member_profile_12368.html)

<sup>7</sup> See [www.isleofwighttouristguide.com/Articles/Article\\_52.asp](http://www.isleofwighttouristguide.com/Articles/Article_52.asp)

<sup>8</sup> See [www.islandbreaks.co.uk/site/about-the-isle-of-wight/weird-and-wonderful-facts](http://www.islandbreaks.co.uk/site/about-the-isle-of-wight/weird-and-wonderful-facts)

3.4 The ferry services are, therefore, an essential service to the island for residents, tourists and the transport of goods.

3.5 Table 3.1 below shows the volume of cross Solent traffic. Passenger vehicles and freight and coaches are measured in car equivalent units (CEU's<sup>9</sup>).

Table 3.1: Volume of cross Solent traffic by segment

Passenger vehicles	1.7 million CEU
Freight and coach	1.4 million CEU
Foot passengers	3.9 million passengers

Source: Red Funnel and Isle of Wight Council data 2008

3.6 While roughly half of foot passenger traffic originates on the mainland, vehicle traffic mainly emanates from the mainland and comprises predominantly tourists.<sup>10</sup> This makes demand for the car ferries very seasonal with much larger numbers travelling in the summer months and September than from October to Easter.<sup>11</sup>

3.7 There are three main providers of ferry services: Wightlink Limited (Wightlink),<sup>12</sup> Southampton Isle of Wight and South of England Royal Mail Steam Packet Company Limited trading as Red Funnel (Red

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<sup>9</sup> Unit of measurement indicating the car carrying capacity of a vessel.

<sup>10</sup> See table 2 of the report compiled by STS, entitled 'Report on ferry fares to the Isle of Wight for Andrew Turner, MP dated 25 March 2009.

<sup>11</sup> See table 3 of the report compiled by STS, entitled 'Report on ferry fares to the Isle of Wight for Andrew Turner, MP dated 25 March 2009.

<sup>12</sup> [www.wightlink.co.uk](http://www.wightlink.co.uk)

Funnel)<sup>13</sup> and Hovertravel Limited (Hovertravel).<sup>14</sup> The three operators have a combined annual turnover of approximately £90 million.<sup>15</sup>

## Routes and operators

3.8 The Isle of Wight is served by six ferry routes. Passenger and car ferry services connect Fishbourne and Ryde to Portsmouth, West and East Cowes to Southampton, and Yarmouth to Lymington. A hovercraft service operates between Ryde Esplanade and Southsea.<sup>16</sup> The routes and operators are shown in Figure 3.2.

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<sup>13</sup> [www.redfunnel.co.uk/](http://www.redfunnel.co.uk/)

<sup>14</sup> [www.hovertravel.co.uk/](http://www.hovertravel.co.uk/)

<sup>15</sup> Source: financial information supplied by Wightlink, Red Funnel and Hovertravel.

<sup>16</sup> See paragraph 1.4.2 of the Cross Solent Movement Study, prepared by MVA for the Isle of Wight Council in June 2006 which can be found at [iow-consult.limehouse.co.uk/file/333695](http://iow-consult.limehouse.co.uk/file/333695).

Figure 3.2: Cross Solent ferry routes and operators



3.9 Wightlink operates a fast catamaran service from Ryde to Portsmouth (Fastcat). This links with South West Trains<sup>17</sup> services at Portsmouth Harbour and the Island Line<sup>18</sup> at Ryde pier head. The crossing time is approximately 20 minutes.

3.10 Wightlink also operates a roll-on roll-off car ferry service from Fishbourne to Portsmouth. This predominantly serves customers travelling by vehicle and freight, rather than foot passengers. The crossing time is approximately 40 minutes. This route has good access links from the M3/M27 motorways on the mainland and reasonably good access to the Isle of Wight road network on arrival. This is the most heavily used route for customers travelling by car and for freight customers.

<sup>17</sup> [www.southwesttrains.co.uk/SWTrains](http://www.southwesttrains.co.uk/SWTrains)

<sup>18</sup> [www.island-line.co.uk/](http://www.island-line.co.uk/)

- 3.11 Wightlink's third route is a roll-on roll-off car ferry from Yarmouth to Lymington. This route is less heavily used than the other routes, since the major population centres on the Isle of Wight are located on the east rather than west side. This route is the shortest vehicle crossing and historically has had a journey time of approximately 30 minutes. We have noted complaints<sup>19</sup> that difficulties surrounding the introduction of new ferries<sup>20</sup> on this route mean that at present the journey takes longer.<sup>21</sup> It is not yet clear how these difficulties will be resolved. There is a train service on the mainland side of the crossing which is timetabled to meet the ferry at Lymington. Rail passengers have to change trains at Brockenhurst to access the mainline.<sup>22</sup>
- 3.12 Red Funnel operates a roll-on roll-off car ferry service between Southampton and East Cowes. This is a longer route than those operated by Wightlink and the crossing time is just under an hour.
- 3.13 Red Funnel also operates a fast passenger catamaran service (Red Jet) between Southampton and West Cowes. This has a crossing time of 25 minutes.
- 3.14 There is a free<sup>23</sup> bus service between Southampton train station and Red Funnel's ferry port facilities. The transfer time between the ferry port

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<sup>19</sup> For example, see [www.iwcp.co.uk/news/news/ferry-problems-were-a-bit-of-a-fag-26035.aspx](http://www.iwcp.co.uk/news/news/ferry-problems-were-a-bit-of-a-fag-26035.aspx)

<sup>20</sup> Wightlink's recent introduction of new ferries on this route is currently the subject of judicial review proceedings (see [www.rlymyc.org.uk/Ferries/documents/EISummaryMay2009V2.pdf](http://www.rlymyc.org.uk/Ferries/documents/EISummaryMay2009V2.pdf)).

<sup>21</sup> Although, Wightlink contend that journey times on this route had increased prior to the introduction of the new vessels. It says the increase was due to the installation of Automatic identification systems (AIS) equipment which enabled speed to be more accurately measured. AIS equipment is designed to be capable of providing information about the ship to other ships and to coastal authorities automatically.

<sup>22</sup> [www.brockenhurst-newforest.org.uk/Transport.html](http://www.brockenhurst-newforest.org.uk/Transport.html)

<sup>23</sup> We have been told that Red Funnel makes a contribution to the running costs in order to ensure the bus service is free.

and the train station is about 10 minutes. There are no train links from East or West Cowes.

- 3.15 Table 4.3 in Chapter 4 compares the total travelling times from the Isle of Wight to various destinations on the mainland using both Red Funnel and Wightlink's routes.
- 3.16 Hovertravel operates a passenger only service from Ryde Esplanade to Southsea. The crossing time is 10 minutes.<sup>24</sup> The Hoverbus runs between the terminal at Southsea and Portsmouth & Southsea train station.<sup>25</sup> The ticket price is one pound.<sup>26</sup> While the Hoverbus is timetabled to meet incoming hovercraft, we understand it is not timetabled to meet any trains arriving at or departing from Portsmouth station.<sup>27</sup>
- 3.17 Passengers travelling from Portsmouth, Southampton and Southsea to the Isle of Wight primarily come from London and the South East of the UK. The Yarmouth to Lymington route primarily serves the New Forest, South West and West Country. In addition to the above noted operators, Blue Funnel<sup>28</sup>, Gosport Ferries<sup>29</sup>, Puffin Cruises<sup>30</sup> and Hurst Castle

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<sup>24</sup> We have been told that the crossing time is usually less than this.

<sup>25</sup> [www.hovertravel.co.uk/pages/hoverbus-route/](http://www.hovertravel.co.uk/pages/hoverbus-route/)

<sup>26</sup> Hovertravel is currently subsidising the Hoverbus service to ensure that the £1 fare is maintained for passengers. In addition, Hovertravel offers multiples of bus tickets which provide further discounts for regular commuting passengers.

<sup>27</sup> The Hoverbus service from the Southsea terminal passes via a number of stop off points in Portsmouth including Gunwharf Quay shopping centre.

<sup>28</sup> [www.bluefunnel.co.uk/](http://www.bluefunnel.co.uk/)

<sup>29</sup> [www.gosportferry.co.uk/](http://www.gosportferry.co.uk/)

<sup>30</sup> [www.puffincruiseslymington.com/](http://www.puffincruiseslymington.com/)

Ferries<sup>31</sup> provide more limited and less intensive (and in some cases seasonal) cross Solent passenger only services. Some of them (Blue Funnel, Gosport Ferries and Hurst Castle Ferries, for example) only operate a limited or daily cruise service in the peak summer months or offer seasonal Christmas shopping trips to the West Quay shopping mall in Southampton. Puffin Cruises does operate daily services,<sup>32</sup> between Yarmouth harbour and Lymington Quay.

## Port ownership arrangements

- 3.18 On the Isle of Wight, Wightlink owns the freehold for the Ryde Pier head terminal and Pier Promenade. At Fishbourne, Wightlink leases some of the foreshore but owns the freehold on the land and terminal buildings. At Yarmouth, it has an agreement of unlimited term with Yarmouth Island Harbour Commissioners.
- 3.19 On the mainland, Wightlink leases the Gunwharf Terminal (roll-on roll-off) and Portsmouth Harbour Terminal (Fastcat) from Portsmouth City Council on long-term leases.<sup>33</sup> In addition, it leases some of the foreshore at both Portsmouth and Lymington. Wightlink owns the freehold on the terminal buildings and car park facilities at Portsmouth and the terminal buildings at Lymington.
- 3.20 Red Funnel owns the freehold for the terminals at West Cowes (Red Jet) and East Cowes (roll-on roll-off), although it leases some of the foreshore at East Cowes from the Crown Commissioners. Red Funnel also leases part of the foreshore at West Cowes. Red Funnel used to own a 50 per cent interest in Thetis Wharf but this was sold in January 2007.

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<sup>31</sup> [www.hurstcastle.co.uk/ferries.html](http://www.hurstcastle.co.uk/ferries.html)

<sup>32</sup> For the timetable see [www.puffincruiseslymington.com/daily-ferry-service.php](http://www.puffincruiseslymington.com/daily-ferry-service.php)

<sup>33</sup> The lease for the Gunwharf Terminal is for 60 years duration and commenced in 1998; the lease for Portsmouth Harbour Terminal is for 1,000 years duration and commenced in 1734. Source: Wightlink.

- 3.21 On the mainland, Red Funnel leases Terminal 1 (roll-on roll- off) and Terminal 2 (Red Jet) at Southampton from Associated British Ports Holdings Limited on long-term leases.<sup>34</sup>
- 3.22 Hovertravel leases the land at both Ryde and Southsea from the Isle of Wight Council and Portsmouth City Council, respectively.<sup>35</sup> The leases permit Hovertravel to operate a hovercraft service from the areas, though its operating times are restricted by the lease conditions. It owns the terminal buildings (on a leasehold basis) that it has built on the leased land.

### Company ownership

- 3.23 There have been a number of changes in ownership of the ferry operators in recent years.
- 3.24 Wightlink was privatised on 1 July 1984, having been owned previously by British Rail (under the name 'Sealink'), hence the connections with train services on both the island and mainland. On privatisation it was acquired by Sea Containers Limited. In 1991 Sealink changed its name to Wightlink. Sea Containers Limited sold Wightlink to a management buy-in in 1994, led by Michael Aiken and financed by CinVen. In 2005 Wightlink was acquired by the Macquarie European Infrastructure Fund (MEIF).<sup>36</sup>
- 3.25 Red Funnel was acquired by Associated British Port Holdings plc (ABP) in 1989. ABP sold the Red Funnel Group to J P Morgan Partners

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<sup>34</sup> The lease for Terminal 1 is of 34 years duration; the lease for Terminal 2 is for 25 years duration. Both commenced in 2000.

<sup>35</sup> The land is leased from Portsmouth City Council for a period of 15 years. The land leased from the Isle of Wight Council is leased for a period of 21 years (extendable to 60 years).

<sup>36</sup> See [www.wightlinks.com/Macquarie\\_European.pdf](http://www.wightlinks.com/Macquarie_European.pdf) and see [www.telegraph.co.uk/finance/2917633/Ferry-chiefs-ship-comes-in-with-Wightlink-sale.html](http://www.telegraph.co.uk/finance/2917633/Ferry-chiefs-ship-comes-in-with-Wightlink-sale.html)

Incorporated (J P Morgan) in 2001.<sup>37</sup> In 2004 Red Funnel's management, in partnership with HBOS, purchased the company from J P Morgan.<sup>38</sup> In June 2007, Red Funnel was sold by its management team and HBOS to Infracapital Partners LP (Infracapital), the infrastructure fund managed by M&G Investment Management Limited, the investment management business of the Prudential group.<sup>39</sup> Infracapital also owns a 10 per cent stake in ABP, which leases the terminal facilities at Southampton to Red Funnel.

- 3.26 Hovertravel is 99.92 per cent owned by the Bland Group Resources Limited (Bland Group).<sup>40</sup> The Bland Group has owned 25 per cent of Hovertravel from 1968 and took a controlling interest in April 2008.

## Previous investigations

- 3.27 There have been a number of competition investigations into cross Solent ferry services.
- 3.28 Following a referral from the then Director General of Fair Trading<sup>41</sup>, the then Mergers and Monopolies Commission (MMC)<sup>42</sup> conducted an investigation in 1990 into the supply of ferry services between the Isle

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<sup>37</sup> See [www.telegraph.co.uk/finance/markets/2810094/Prudential-buys-Isle-of-Wight-ferry-firm.html](http://www.telegraph.co.uk/finance/markets/2810094/Prudential-buys-Isle-of-Wight-ferry-firm.html)

<sup>38</sup> Source: Wikipedia

<sup>39</sup> See [www.telegraph.co.uk/finance/markets/2810094/Prudential-buys-Isle-of-Wight-ferry-firm.html](http://www.telegraph.co.uk/finance/markets/2810094/Prudential-buys-Isle-of-Wight-ferry-firm.html)

<sup>40</sup> [www.blandgroup.com/index.html](http://www.blandgroup.com/index.html)

<sup>41</sup> The position of Director General of Fair Trading was abolished by the Enterprise Act 2002 and, amongst other things, its functions were transferred to the Office of Fair Trading, acting as a corporate body.

<sup>42</sup> The MMC was replaced by the Competition Commission on 1 April 1999.

of Wight and the mainland.<sup>43</sup> At the time of the investigation there were four operators providing cross Solent services - Wightlink, Red Funnel, Hovertravel and Cowes Express, which operated passenger only services between Southampton and West Cowes.<sup>44</sup> Shortly after the publication of the MMC report in 1991, Cowes Express ceased trading.

3.29 The main conclusions of the 1991 MMC report were that:

- a monopoly situation existed in favour of Wightlink and Sea Containers
- neither the level of profitability nor its level of fares was sufficient to be regarded as against the public interest
- many aspects of the services benefited the users, in particular, the increased capacity and usage of the ferry services over time, and the availability of cheap promotional fares
- despite arguments put forward that the ownership by ferry operators of port facilities would prevent new entry, the investigation found insufficient grounds to justify such a conclusion
- although no aspects of Wightlink's performance were considered to be against the public interest, the MMC concluded that the competition faced by Wightlink could not be regarded as strong

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<sup>43</sup> [www.competition-commission.org.uk/rep\\_pub/reports/1992/fulltext/315c1.pdf](http://www.competition-commission.org.uk/rep_pub/reports/1992/fulltext/315c1.pdf)

<sup>44</sup> Up until 27 February 1994 Red Funnel used to travel from Southampton to West Cowes and then onto East Cowes. The Cowes Express travelled between Southampton and West Cowes only.

- Wightlink had a dominant position which could be open to abuse and there may be a need for further monitoring of its profitability and fares in the future.

3.30 In 1996 the OFT reviewed the market for cross Solent ferry services, as recommended by the MMC report. This review found that the market had not substantially changed since the MMC published its report in 1991 and that there was insufficient evidence to suggest that profits were excessive.

3.31 In 2001 the OFT received a complaint from Dr Peter Brand, MP (Andrew Turner, MP's predecessor) about fare increases by Wightlink. This was followed up by a further complaint alleging a lack of competition in ferry services to the West of the Island. The OFT opened investigation under section 25 of the Competition Act 1998 and requested information from Red Funnel and Wightlink under section 26 of the Act. The OFT concluded on the basis of the information supplied by Red Funnel and Wightlink that no further investigation into the allegations was warranted.

## 4 COMPETITION BETWEEN OPERATORS

- 4.1 In this section we discuss the extent of competition between the different routes and operators.
- 4.2 The OFT's guidance provides that, in making an MIR to the Competition Commission, the OFT must specify the goods or services for whose supply or acquisition competition is adversely affected and this will require 'some consideration of the definition of the relevant market'. In addition, it provides that '[t]he effects on competition of some feature may be clear enough that firm conclusions on the definition of the relevant market by the OFT are unnecessary'.<sup>45</sup>
- 4.3 Ferry services are the only means of public transport to and from the island. On this basis, we consider that the relevant market could not be any wider than ferry services to and from the Isle of Wight.
- 4.4 In this section, we consider the extent to which the three operators act as a competitive constraint on one another, which includes considering whether they operate in the same economic markets, and look at whether this has changed over time.
- 4.5 We consider the following aspects in turn:
- Foot passengers:
    - competition between Red Funnel's West Cowes-Southampton Red Jet service and Wightlink's and Hovertravel's Ryde-Portsmouth/Southsea Fastcat and hovercraft services
    - competition between Wightlink's Ryde-Portsmouth Fastcat service and Hovertravel's Ryde-Southsea hovercraft service.

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<sup>45</sup> OFT 511, 'Market Investigation references: Guidance about the making of references under Part 4 of the Enterprise Act' (March 2006), at paragraph 4.8.

- Vehicle ferries:
  - competition between Red Funnel and Wightlink
  - potential for competition between Wightlink's Fishbourne-Portsmouth and Yarmouth-Lymington routes.

## Foot passengers

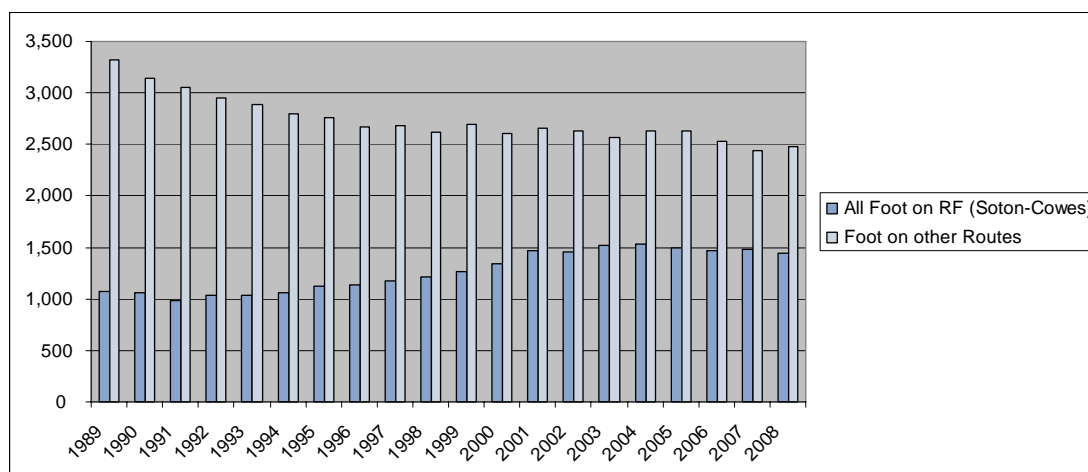
### Competition between West Cowes-Southampton and Ryde-Portsmouth/Southsea

- 4.6 In the 1991 MMC report into cross Solent ferries, foot passenger services to Southampton were considered to be in a separate market to foot passenger services to Portsmouth. The time it takes to travel between departure ports and destination ports (on the Isle of Wight and the mainland) by public transport meant that the two routes did not compete heavily. The MMC said the two routes were closer competitors for the minority of passengers who used them to travel from Newport to London (where using the Red Jet from West Cowes to Southampton would make the journey quicker than using the service from Ryde to Portsmouth).<sup>46</sup>
- 4.7 While several of the factors which led to these routes being considered in separate markets have not changed significantly since 1991 (for example, journey times by public transport, which are shown in Table 4.3 further below), Chart 4.1 records that the number of passengers using the Red Jet has increased over time while those using the Fastcat has fallen.

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<sup>46</sup> Table 2.4 of the MMC report, available at [www.competition-commission.org.uk/rep\\_pub/reports/1992/315crosssolent.htm#full](http://www.competition-commission.org.uk/rep_pub/reports/1992/315crosssolent.htm#full)

Chart 4.1: Increase in the number of passengers using the Red Jet



4.8 An analysis of Wightlink's 2006 customer satisfaction survey shows that around half of island residents had used both routes. However, we do not consider the fact that passengers have used both services, in itself, means that for any single journey they are both in competition – the destination may determine the choice of route.

4.9 We have also analysed data<sup>47</sup> on train tickets and found that both the Red Jet and Fastcat have significant volumes of passengers booking tickets between the Isle of Wight and the same mainland destinations. For example, 31 per cent of passengers going from the Isle of Wight to London travelled on the Red Jet, with most of the rest using Wightlink's Fastcat.<sup>48</sup> This would suggest that, for passengers on these journeys, the alternative foot passenger services may be in competition. However, passengers buying connecting rail and ferry tickets to this destination account for less than 10 per cent of the Red Jet's customers.

<sup>47</sup> South West Trains data on passengers booking a through train ticket from the Isle of Wight (including a ferry crossing).

<sup>48</sup> The base is passengers travelling from the Isle of Wight to London via train and booking an inclusive ticket with rail and ferry journey travelled

- 4.10 A 2006 Wightlink passenger survey concerning the Fastcat service found that most passengers were not travelling further than Portsmouth.<sup>49</sup> In addition, some 70 per cent of passengers emanating from the mainland and using the Fastcat were travelling to the Ryde area or taking the Island Line rail service from Ryde. This suggests that these passengers could not easily have switched to the Red Jet service.
- 4.11 Our conclusion is that, although there is some evidence of competition between these two routes - for example, evidence of passengers having used both services, and evidence that significant numbers of people use each of the two services when travelling by train to London - and evidence that Red Funnel has won market share from Wightlink over time, switching may not be a realistic option for the majority of customers and inter-route competition for foot passengers therefore cannot be regarded as strong.

#### Competition between Ryde-Portsmouth and Ryde-/Southsea

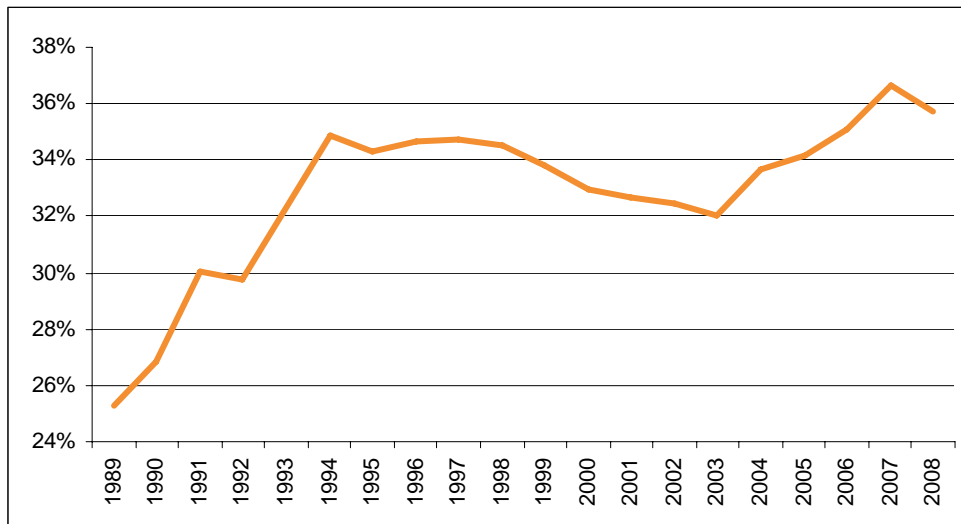
- 4.12 The MMC report found that there was direct competition between Wightlink's Fastcat service between Ryde and Portsmouth and Hovertravel's service between Ryde and Southsea, and we consider this still to be the case. The two mainland ports are only about a mile (or 5 minutes by road) apart.
- 4.13 However, we have noted that the two services do not appear to compete for passengers travelling to or from Portsmouth by train – very few through train tickets are sold including the hovercraft, perhaps because the Hovertravel service does not connect as directly with the train. That having been said, less than 40 per cent of Fastcat passengers fall into this category, which suggests that the majority of customers do face a genuine choice of service.

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<sup>49</sup> Relatively few (maybe about a third) were travelling a significant distance (such as 20 per cent going to London, five per cent abroad and six per cent to the Southampton area).

4.14 Chart 4.2 below records that Hovertravel has taken market share from the Fastcat in recent years. This may reflect the fact that Hovertravel has increased the number of sailings slightly in recent years, while the Fastcat timetable has remained largely unchanged.

Chart 4.2: Hovertravel's share of the foot passenger market to and from Ryde



4.15 Consistent with the MMC finding, we believe that the Hovertravel and Fastcat services compete directly. The different attributes of the Hovertravel service (such as its mainland departure point being outside the city centre and its less direct connection to the Portsmouth trains) do not prevent it being a suitable alternative for many of the foot passengers travelling out of Ryde or Portsmouth.

## Vehicle ferries

### Competition between Red Funnel and Wightlink

4.16 The 1991 MMC report found that Red Funnel and Wightlink were competing in the same vehicle ferry market. Within that market, however, the MMC concluded that Wightlink held a dominant position and that competition between the two operators was not strong enough to ensure that Wightlink could not abuse its market power. This was

partly due to the then low capacity of the Red Funnel's ferries and its high operating costs per unit, which limited the threat it posed to Wightlink.

- 4.17 As evidenced in table 4.3 below, one factor in support of placing the two companies in the same market for vehicle traffic was and remains the fact that travelling times from London or the Midlands to the Isle of Wight are similar regardless of whether the Southampton or Portsmouth route is used.

Table 4.3: Travelling times<sup>50</sup> from the Isle of Wight to mainland destinations

		By Car		By Foot	
All figures in minutes		RF	WL	RF	WL
From	To	Est. Journey Time	Est. Journey Time	Est. Journey Time	Est. Journey Time
Newport	London	168	156	125	134
Ryde	London	174	152	155	112
Newport	Birmingham	218	214	183	230
Ryde	Birmingham	224	210	213	208
Newport	Southampton Airport	83	78	57	99
Ryde	Southampton Airport	89	74	64	77
	Crossing times	60	40	30	15
	Modal changes			RF: 3	WL: 2

Source: Google Maps

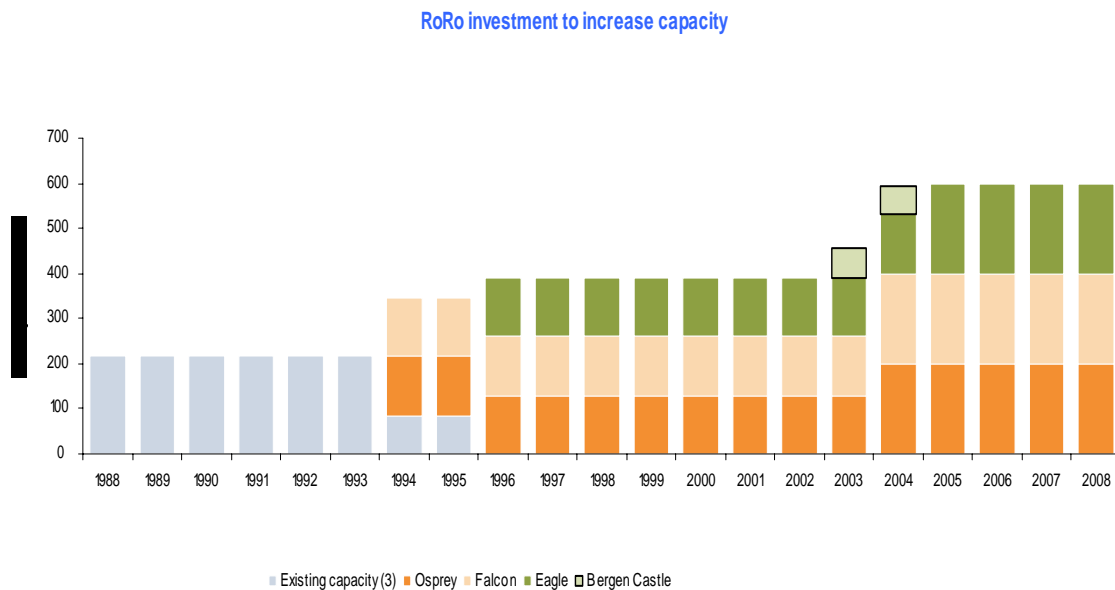
Source: Red Funnel

<sup>50</sup> We understand that the Red Jet crossing time is usually 25 minutes.

4.18 Set against this, customer survey evidence provided by Wightlink suggests that, for many customers, the physical characteristics of the routes, notably the location of the ports and ease of road access, are more important factors in choosing which way to travel than price – these customers may not easily be induced to switch between the two routes. Consistent with this, we have seen little evidence of either company aggressively targeting its rival's customers – most marketing effort is geared towards increasing the volume of traffic, in particular tourism, to the Isle of Wight and capturing a share of that increase.

4.19 As can be seen from chart 4.4, since 1991 the Red Funnel ferries have approximately trebled in size (through a combination of bringing on new vessels and the stretch programme<sup>51</sup> which increased the capacity of all three vessels from Q4 2003 to Q1 2005) and now compete for a much larger proportion of the cross Solent vehicle market.

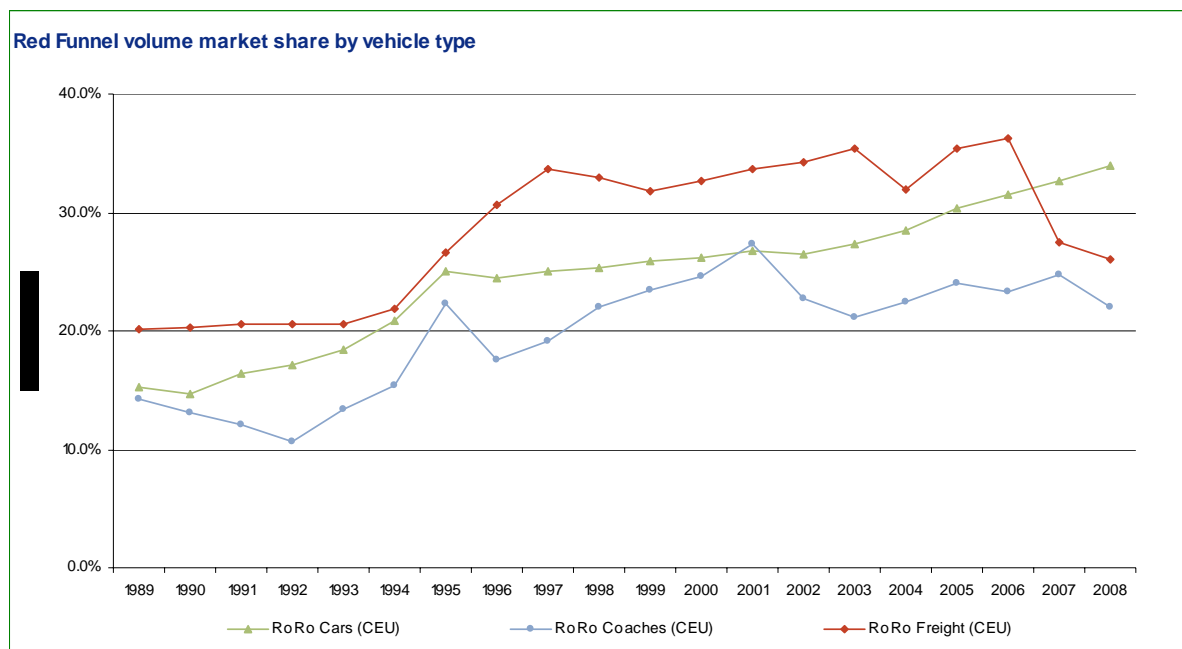
Chart 4.4: The increase in size of Red Funnel's roll-on roll-off fleet



<sup>51</sup> This involved adding new sections into existing craft to increase capacity.

4.20 Figure 4.5 underlines that Red Funnel has increased market share significantly in all three vehicle segments (cars, coaches and freight), though coach and freight market shares appear to have declined from their peak more recently. On a total CEU (car equivalent units) basis, Red Funnel's share reached 35 per cent in 2006, which is a significant increase from less than 20 per cent in 1991.

Figure 4:5 Growth in Red Funnel market share



4.21 In 1991 the MMC found that the prices of the two operators were similar, suggesting that Red Funnel was unable to recoup its higher operating costs (incurred on the longer crossing) in higher fares – in other words, Red Funnel's pricing was constrained by competition from Wightlink. According to Red Funnel's submission but also other documentary evidence we have seen, this remains the case.

4.22 Our conclusion, therefore, is that there is a degree of competition between the two operators, although this is asymmetric. Given its longer journey time, higher operating costs and smaller market share, Red Funnel is more constrained by Wightlink than vice versa. However, it appears that Red Funnel is a more significant competitive constraint on Wightlink now than it was in 1991.

## Potential for competition between the Fishbourne-Portsmouth and Yarmouth-Lymington routes

- 4.23 Both the Fishbourne-Portsmouth and Yarmouth-Lymington routes are operated by Wightlink. We have considered, however, the extent to which these routes might compete with one another if under separate ownership.
- 4.24 The MMC noted that Wightlink's Yarmouth to Lymington route has a slightly different offering to the routes on the east of the island and caters for different traffic.<sup>52</sup> For example, it has lower freight volumes and the road access, particularly on the mainland side, is considered less accessible and is used less by people that are new to the island.<sup>53</sup>
- 4.25 Most major customers that we consulted (whether car, freight, or coach) agreed that Southampton was a better alternative to Lymington than was Portsmouth.
- 4.26 We conclude that, while both Wightlink routes constrain the Red Funnel route to some extent, and to a lesser extent vice versa, it is not clear that the two Wightlink routes would represent an additional competitive constraint on each other if under separate ownership.

## Conclusions on extent of competition between existing operators

- 4.27 In the foot passenger market, the Ryde-Portsmouth Fastcat and Ryde-Southsea hovercraft compete for a significant proportion of customers and could be considered to be in direct competition. Hovertravel has won some market share from Wightlink over time. The Red Jet service competes less directly for foot passenger traffic.

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<sup>52</sup> Also see paragraph 2.4.3 of the Cross Solent Movement Study, prepared by MVA for the Isle of Wight Council in June 2006

<sup>53</sup> The OFT notes that Wightlink may face some competition on the Yarmouth- Lymington route from Puffin Cruises in connection with foot passengers. See [www.puffincruiseslymington.com/](http://www.puffincruiseslymington.com/)

4.28 In the vehicle market, there is asymmetric competition between the two operators – Red Funnel is more constrained by Wightlink than vice versa. However, Red Funnel appears to be a more significant competitive constraint on Wightlink now than it was in 1991. There seems to be very limited potential for the Fishbourne-Portsmouth and Yarmouth-Lymington routes to compete with one another if they were under separate ownership.

## 5 PROSPECTS FOR NEW ENTRY

5.1 This Chapter presents our views on the potential for new entry, and the extent to which the threat of new entry constrains the existing ferry operators. In particular we have considered:

- the existence of barriers to entry
- the potential for the routes to support more competition.

### Barriers to entry

5.2 Entry barriers are factors that allow an undertaking profitably to sustain supra-competitive prices in the longer term without being more efficient than potential rivals. Where undertakings have a large market share but entry barriers are low then it is more likely that the threat of potential competition will prevent undertakings already in the market being able profitably to raise prices above competitive levels.<sup>54</sup>

5.3 We have seen statements by the operators which suggest that, from a commercial perspective, material barriers to entry exist.

5.4 For example, the following is an extract from a Wightlink bond issue document from 1999:

'Market entry is constrained by access to port facilities...Wightlink considers that any port from which, in practical terms, ferry services could be operated across the Solent is already being used for that purpose by the current operators and that the existing ports do not have sufficient excess capacity to allow a potential entrant to provide a competing service'.

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<sup>54</sup> See OFT Guideline *Assessment of Market Power* (OFT 414) for more information about entry barriers.

5.5 Wightlink also stated in its submission to this study '...that there are certain barriers to entry that make potential entry more difficult – but far from impossible – than might otherwise be the case'.<sup>55</sup>

5.6 The following is an extract from a press release issued at the time Infracapital acquired Red Funnel in June 2007:

'Red Funnel has been running the Southampton-Cowes route since 1861 and now operates seven vessels. Red Funnel's attraction to infrastructure funds is that it offers reliable income in a market with high barriers to entry'.<sup>56</sup>

5.7 In the following sections, therefore, we consider in relation to barriers to entry:

- access to alternative port facilities, both on the mainland and on the Isle of Wight
- use and/or ownership of the existing port facilities by the incumbent operators
- the scope for building new port facilities on the Isle of Wight.

5.8 It should be noted, at this point, that we sought the views of a number of other ferry operators. Unfortunately, we did not receive any substantive responses. The majority of respondents simply confirmed that they had no plans to commence ferry services either on existing cross Solent ferry routes or new routes not currently being operated. None of the operators we approached advanced any views on the difficulties or otherwise of leasing suitable port facilities or what it would take to be able to compete on a cross Solent ferry route. The question of

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<sup>55</sup> Wightlink's April 2009 submission, paragraph 5.4.7 on page 35.

<sup>56</sup>

[www.lovells.com/Lovells/MediaCentre/PressReleases/Archive/2007/Lovells + advises + Infracapital + on + %C2%A3200m + Isle + of + Wight + ferry + acquisition.htm](http://www.lovells.com/Lovells/MediaCentre/PressReleases/Archive/2007/Lovells+advises+Infracapital+on+%C2%A3200m+Isle+of+Wight+ferry+acquisition.htm)

whether there is sufficient demand to attract new entry, even absent barriers, is dealt with in the second half of this Chapter.

## Alternative port facilities on the mainland and on the Isle of Wight

- 5.9 The Port of Southampton is a major world port, owned and run by ABP, a subsidiary of Associated British Ports Holdings Limited (ABPH). Red Funnel's owner, Infracapital, has a minority interest in ABPH. However, we have no evidence to suggest that ABPH has ever been or would be reluctant to lease port facilities to a competitor to Red Funnel on normal commercial terms. We also note that, at the time of the previous MMC enquiry, ABPH owned Red Funnel so Red Funnel's ability to influence ABP's policy with regard to access to its facilities is likely to be less now than it might previously have been.
- 5.10 Nonetheless, we have been told that leasing facilities in the Port of Southampton would be a major expense to a cross Solent ferry operator looking to operate a regular service out of those facilities.
- 5.11 There is spare capacity at Portsmouth's Continental Ferryport (which is owned by Portsmouth City Council), which could accommodate a vehicle ferry (and Wightlink has contingency plans in place to operate from there in the event that the Gunwharf terminal cannot be used). Again, we have been advised that leasing facilities in the Continental Ferryport would be a significant cost to a potential cross Solent ferry operator looking to operate a regular service out of those facilities.
- 5.12 There do not appear to be any suitable port facilities on the Isle of Wight which could accommodate another vehicle ferry, which are not currently being used in that capacity. Such facilities that could be leased are suitable only for passenger carrying vessels of a limited size (such as the Thetis Wharf facilities in Cowes which are currently leased by Solent and

Wightline Cruises<sup>57</sup> and their sister company, Blue Funnel<sup>58</sup>) or for transporting freight.

- 5.13 We conclude, therefore, that a putative new entrant should be able to access port facilities on the mainland, albeit at a high price. There may be facilities on the island which could be used by a passenger ferry, but there are no existing facilities on the island (other than those that are already in use) which would be suitable for a vehicle ferry. New entry by a vehicle ferry would, therefore, require either access to facilities currently in use by the incumbent operators, or the construction of additional port facilities on the island.

### Facilities in use by incumbent operators

- 5.14 There appears to have been little change in the ownership of the existing port facilities or the relevant ports legislation since the MMC report, except for the fact that Red Funnel no longer owns a 50 per cent interest in Thetis Wharf. The ownership arrangements are described in detail in Chapter 3.
- 5.15 We note also that ferry operators sometimes act as the relevant harbour authority<sup>59</sup> for the terminals from which they operate their services. In this connection, Wightlink is the statutory harbour authority for Portsmouth Harbour Railway Jetty, for part of Ryde Pier, for the terminal at Fishbourne and for Lymington Pier.<sup>60</sup> In principle, this would afford a ferry operator, which did not own the harbour facilities but which was still its harbour authority, the opportunity to block access by a potential

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<sup>57</sup> [www.Solentcruises.co.uk](http://www.Solentcruises.co.uk)

<sup>58</sup> [www.bluefunnel.co.uk/](http://www.bluefunnel.co.uk/)

<sup>59</sup> For more information see [www.dft.gov.uk/pgr/shippingports/ports/pmsc/aguidetogoodpracticeonportma4961?page=2](http://www.dft.gov.uk/pgr/shippingports/ports/pmsc/aguidetogoodpracticeonportma4961?page=2)

<sup>60</sup> Red Funnel does not act as the relevant harbour authority in either Cowes or Southampton. Similarly, Hovertravel does not act as the harbour authority in Ryde or Southsea.

new entrant. However, we note that virtually every harbour authority's statutory powers are subject to what is known as the 'open port duty'.<sup>61</sup> The 'open port duty' is given effect by Section 33 of the Harbours, Docks and Piers Clauses Act 1847 (Harbours Act). The Harbours Act, in essence, provides for third parties, to be able to seek access to facilities owned or controlled by incumbents upon payment of the rates made payable by the local legislation for that port.<sup>62</sup> Although, we understand that entry may be refused on reasonable operational grounds. General competition law also may allow for access in certain circumstances to essential facilities and there exists precedent in the ports sector to support this.<sup>63</sup>

5.16 In its 1991 report, the MMC concluded that there were insufficient grounds to establish that the control of the relevant ports by the incumbent operators had operated as a barrier to entry, or that the existing provisions of ports legislation were insufficient to allow access to ports on reasonable terms. We have come to broadly the same conclusion - ownership or control of existing facilities by incumbents is not obviously, of itself, a prohibitive barrier to entry.

5.17 However, we recognise that there are logistical issues which make shared access difficult or impossible. First and foremost, we understand that the existing facilities are not sufficiently large to allow, in particular, more than one roll-on roll-off ferry to load or unload at any one time. There is also limited space available for marshalling and loading vehicles,

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<sup>61</sup> For more information on this duty, see [www.dft.gov.uk/pgr/shippingports/ports/pmsc/portmarinesafetycodepartoneh4962?page=2#P42\\_5538](http://www.dft.gov.uk/pgr/shippingports/ports/pmsc/portmarinesafetycodepartoneh4962?page=2#P42_5538)

<sup>62</sup> Section 33 provides that: 'upon payment of the rates made payable by this and of the Special Act [i.e. the local Act incorporating the section], and subject to the other provisions thereof, the harbour, dock and pier shall be open to all persons for the shipping and unshipping of goods, and embarking and landing of passengers'.

<sup>63</sup> See, for instance, B&I Line plc/Sealink Harbours [1992] 5 CMLR 255 and Sea Containers/Stena Sealink [1994] OJ L518/8.

which would make the use of the port facilities by two operators very complex.<sup>64</sup>

5.18 Furthermore, there are some site-specific issues. For example, at Fishbourne, there are physical limitations on the type of vessel which can use the facilities because of the narrow water channel approach and shallow waters.

5.19 Wightlink commented on these issues in its submission as follows:

'...the topography of the Solent means that there is a limit on the number of vessels that can access the various termini on the mainland and the Isle of Wight due, for example, to the relatively shallow depth of the water, especially at low tide. For example, it is very difficult (if not impossible) for more than one ferry to approach Fishbourne at any one time and it would not be cost effective to build another berth at Fishbourne without also dredging a second channel which would probably meet with significant opposition on environmental grounds, not least from the local councils and planning authorities; and there is no space for additional berths at the Gunwharf terminal at Portsmouth'.<sup>65</sup>

### Conclusion on access to facilities in use by incumbent operators

5.20 We did not find any evidence during the course of the study to suggest that third party operators had been declined access to existing port facilities by the incumbents. Although we recognise that they are not direct competitors, we note that Blue Funnel and Gosport Ferries have accessed facilities at Ryde Pier and Cowes, while Puffin Cruises and Hurst Castle Ferries have access at Yarmouth Harbour.

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<sup>64</sup> See paragraph 4.3.4 of the Cross Solent Movement Study, prepared by MVA for the Isle of Wight Council in June 2006.

<sup>65</sup> Wightlink's April 2009 submission, paragraph 3.5.6 on page 26.

5.21 However, there are practical considerations which might make such access problematic on anything other than an occasional or non-intensive basis. This is because access on an intensive basis may well compromise the operational efficiency of the incumbent and raise safety concerns at the port in question.

5.22 To this end, a MEIF Investment Committee document produced in June 2005, recommending the purchase of Wightlink (Project Oberon document), comments as follows in the Appendix titled 'Port Access':

'WSL [Wightlink] has indicated that there is very little risk in a competitor entering the cross-Solent market through accessing the ports used by WSL – either as WSL has secured exclusive use through ownership or leasehold arrangements. Additionally, there is legislation [Harbours Act] that may require WSL to permit access, the risk is mitigated through operational issues'

The Project Oberon document goes on to say that:

'...in practice, Wightlink would be able to argue that permitting third party access would interfere with its ongoing activities and thereby refuse access or that the use of associated land is exclusive to Wightlink'.

5.23 In our view, the likelihood of existing port facilities being opened up to competing third parties requesting intensive access using vessels of a comparable size to those of the existing incumbent, while theoretically feasible, seems unlikely in practice. We think this may be primarily a function of physical constraints, rather than a matter of incumbent operators being in a position to deny access.

#### Scope for building alternative port facilities

5.24 For a potential entrant to compete on an equal footing with the existing incumbents, it would need to be able to offer a comparable service, in terms of the scale and intensity of operation, crossing times, frequency of service and connectivity with other onward transport links.

- 5.25 Both Wightlink and Red Funnel have noted that there are other potential sites for port facilities which could be developed in Portsmouth and Southampton. Red Funnel observed, in its submission to the OFT, that it had looked into the possibility of moving its roll-on roll-off operation within the Port of Southampton but, while we have been told that Red Funnel believes that there are alternative facilities within the Port of Southampton that would be potentially suitable for its needs, they also believe that the costs of relocating to, adapting and renting any of those facilities would be prohibitive.
- 5.26 With regard to the Lymington to Yarmouth route, Wightlink has commissioned a report considering the viability of moving its Lymington operation to Pennington Marshes which is a coastal rather than river location.<sup>66</sup>
- 5.27 This suggests that, at least on the mainland, a new entrant could find a suitable location to establish new port facilities provided that they could fund the investment and ongoing costs and obtain the relevant planning consent and regulatory approvals.
- 5.28 On the Isle of Wight, access to alternative port facilities appears more problematic. In practical terms, any new port facility would have to be located along the north coast of the Isle of Wight (ideally, somewhere between East Cowes and Bembridge as this represents the closest link to the South East, London and major airports).
- 5.29 We are aware of a number of initiatives for new port facilities which have been put forward. For example, we are aware that one local landowner put forward a proposal for a new port site to the Isle of Wight Council, involving the sale of existing farm land which could be used to build new port facilities on the headland near to the existing Fishbourne port facilities. As we understand it, while this proposal has been in prospect since the 1990s and remains on the table, no one has as yet come forward with any investment plans or offered to develop this land

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<sup>66</sup> [www.wightlink.co.uk/new-ships/alternative-terminal-location.aspx](http://www.wightlink.co.uk/new-ships/alternative-terminal-location.aspx)

(although we understand some ferry operators have previously expressed interest in using such facilities if they were built).

5.30 In 2008, proposals were also put forward by Civic Networks Limited<sup>67</sup> in response to the Consultation on the Isle of Wight Council Island Plan in February 2008. These proposed a new ferry terminal at Ryde which would be capable of serving both car and passenger ferries, constructed to the west of the existing pier structure. The plans also incorporated a fixed link tram service to Gosport. We have been told by the promoter of this scheme that the funding was available to take forward the proposals, subject to the plans being adopted in the Island Plan. However, the Isle of Wight Council did not support the proposals or include them in the Island Plan.<sup>68</sup>

5.31 We have also considered whether it might be feasible to build new port facilities elsewhere on the Isle of Wight. We understand that to sail into the south to east coast (from Ventnor to Bembridge) would require larger and more expensive sea-going vessels than those currently used by the incumbents in the Solent. In addition, there are no obvious land sites that could be developed due to the terrain on this side of the island, the fact that much of the coastline of the Isle of Wight is designated as an Area of Outstanding Natural Beauty or Sites of Special Scientific Interest,<sup>69</sup> and that the main tourist beaches are situated along this coastline. Even if it were possible, travel times would be much longer than on the existing cross Solent routes and, therefore, not as attractive to passengers.

5.32 Similarly, operating ferry services on the south to west coast (Niton to Freshwater) would have similar problems to those above. Much of the

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<sup>67</sup> [www.iwight.com/living\\_here/planning/images/CivicNetworks.pdf](http://www.iwight.com/living_here/planning/images/CivicNetworks.pdf)

<sup>68</sup> [www.iwight.com/living\\_here/planning/Planning\\_Policy/Island\\_Plan/](http://www.iwight.com/living_here/planning/Planning_Policy/Island_Plan/)

<sup>69</sup> [www.enjoyengland.com/ideas/rural-escapes/landscapes-and-scenery/areas-of-outstanding-natural-beauty/iow.aspx](http://www.enjoyengland.com/ideas/rural-escapes/landscapes-and-scenery/areas-of-outstanding-natural-beauty/iow.aspx)

coastline on this stretch is also inaccessible to shipping because of the landscape.

5.33 In this regard, we also note the submission from Andrew Turner MP which suggests that the prospect of any new port facilities on the Isle of Wight is unlikely. The MP comments on the various plans in his submission as follows:

'In my view these plans are unlikely to come to fruition, if at all, in any reasonable timescale. It is significant that the Local Authority have been made aware of a number of proposals in recent years – yet none have progressed and the newly developed Island Plan which will be the Core Strategy document for development on the Island over the next 15-20 years gives no suggestion that any development on this front is likely and there is no allocation of land for any potential new facilities'.<sup>70</sup>

5.34 The Project Oberon document also comments that:

'The north coast of the [isle] o[f]W[ight] is either designated as a heritage coastline, nature conservation areas or sites of special scientific interest. In this regard, regardless of any potential mainland capacity, a destination port on the [isle] o[f]W[ight] appears to be unlikely to be available'<sup>71</sup>

and

'...the creation of new port facilities (or any form of fixed crossing) is considered unlikely for environmental and cost reasons'.

5.35 In addition, we also take the view that the sunk costs<sup>72</sup> associated with developing new port facilities could potentially be very high. An

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<sup>70</sup> Submission to the Office of Fair Trading regarding Cross-Solent Ferry services, Andrew Turner Member of Parliament for the Isle of Wight, March 2009

<sup>71</sup> Project Oberon document at page 40.

<sup>72</sup> Sunk costs are costs that cannot be recovered once they have been incurred.

undertaking, before committing to an investment of this scale would have to be confident that there was sufficient profitable cross Solent traffic to justify the potential costs involved.

- 5.36 In summary, we believe that while there is potentially some scope for increasing the overall landing capacity by building new port facilities on the Isle of Wight, the prospects of this happening in the short to medium term appear to be very low.

### Conclusions on barriers to entry

- 5.37 We have been unable to test directly with third party ferry operators whether or not obtaining access to suitable port facilities is a substantive barrier to entry. Nonetheless, on the basis of the evidence we have seen, we have come to the following conclusions:

- a potential new entrant probably could access suitable facilities on the mainland at a high price, but access to facilities on the island is more of a problem
- it is possible that facilities exist on the island to serve an additional passenger service, but there are no obvious facilities available to serve an additional vehicle ferry
- it would be difficult for a new entrant operator of a roll-on roll-off ferry service to:
  - share existing port facilities on the Isle of Wight with an existing ferry operator; or
  - establish new roll-on roll-off port facilities on the Isle of Wight in the short to medium term.

- 5.38 Our view is that there would be significant logistical difficulties involved in a new operator sharing any of the facilities currently used by existing operators. Given these logistical difficulties, we do not believe that the ownership or control of facilities by incumbent operators is, of itself, likely to deter entry.

- 5.39 Wightlink contends, in its submission to the Study, that barriers to entry are most relevant where intra-market rivalry is weak and that looking at capacity at existing facilities (rather than barriers to entry as a whole) is only relevant where there is actual or potential demand for additional services. Intra-market rivalry is the subject of Chapter 4. The next section deals with the question of demand for additional services.

### The potential for the market to support more competition

- 5.40 Absent barriers to entry, there is a further question as to whether there is sufficient demand to support new entry.
- 5.41 In its report *Viability of ferry services to and from the island of Jersey*, published in July 2004,<sup>73</sup> the economic consultancy firm Oxera noted that head to head competition on ferry routes was rare. Oxera commented as follows:

'It is notable that Oxera has been able to find few examples of competition other than on heavily used ferry routes (e.g. the cross Channel routes from the UK to France). When there are several operators, there appears to be a tendency for competition to be moderated with few instances of head-to-head competition; routes within a region are differentiated by origin or destination. An example of this can be seen in the ferry services to the Isle of Wight ... where there was only one directly competitive route, and even this was competitive for only a short time.

In general, where there is substantial excess capacity in a market with products that are relatively undifferentiated, competition will tend to be fierce, with little scope for reaching a long-run equilibrium until one of the firms exits the market. Given the available evidence on market

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<sup>73</sup> [www2.gov.je/NR/rdonlyres/7DB16952-D1DC-4FEC-A45A-10F45CB6EB11/0/SDJerseyferryservicesOXERAFinalpaper.pdf?bcsi\\_scan\\_A2018E0826464712=EWNxY0y9Hmw9inKn2LIQFRwAAAAXn2cH&bcsi\\_scan\\_filename=SDJerseyferryservicesOXERAFinalpaper.pdf](http://www2.gov.je/NR/rdonlyres/7DB16952-D1DC-4FEC-A45A-10F45CB6EB11/0/SDJerseyferryservicesOXERAFinalpaper.pdf?bcsi_scan_A2018E0826464712=EWNxY0y9Hmw9inKn2LIQFRwAAAAXn2cH&bcsi_scan_filename=SDJerseyferryservicesOXERAFinalpaper.pdf)

structures, Oxera would expect this to be the situation for ferries. Research by Oxera indicates that there are only three routes in northern Europe on which two or more operators compete directly (Calais–Dover, Dublin–Holyhead and Dublin–Liverpool)'.

- 5.42 We note that there is near head-to-head competition between the passenger only routes operated by Wightlink and Hovertravel from Ryde to Portsmouth and Southsea respectively, since Portsmouth and Southsea are so close to one another.
- 5.43 That observation notwithstanding, we broadly accept Oxera's assessment of the potential for on-route competition in ferry services. On most of the Isle of Wight routes capacity utilisation is low (as discussed in Chapter 6) and it is far from clear that there is sufficient demand to support competition between two operators on a sustainable basis.
- 5.44 Wightlink's Fishbourne to Portsmouth vehicle ferry route, on the face of it, would appear more likely to be able to bear competition than the other routes, since there is sufficient demand at present to support a four-boat service at peak times. However, if there were two ferry operators providing services at half - hourly intervals on this route, the most likely scenario, given the all year round low level of utilisation of the service,<sup>74</sup> would be that each operator would be left with at most one ship running for most of the year. They might run two vessels each at peak times but not outside of those times. This would not allow for economies of scale in maintenance and probably not allow the operators to provide sufficient back-up in the event of problems with their craft. This, in turn, could lead to a major service failure and subsequent loss of reputation and business. As such, it seems unlikely that two operators could viably compete, even on this route.

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<sup>74</sup> See, for instance, paragraph 3.2.8 of the Cross Solent movement Study, prepared by MVA for the Isle of Wight Council in June 2006.

- 5.45 Given that there is significant excess capacity outside peak times, it is possible that a new entrant might seek to enter only during peak times. Our view is that it would be difficult for an operator to offer a frequent, reliable service during rush hour slots without substantial investment. However, a small scale entrant may be able to compete to serve tourists and day trippers in the summer. Consistent with this, the only new entry in recent years has been during Cowes week when Wightlink or one of the other smaller operators, like Gosport Ferry or Blue Funnel, put on additional passenger services to Cowes.
- 5.46 Oxera's analysis suggests that new entry might be more likely with a completely new route (differentiated competition), for example Cowes-Portsmouth. We note, however, that Red Funnel used to run this route but stopped due to insufficient demand.
- 5.47 In our view, it is more likely that, absent barriers to entry, competition would take the form of a challenger entering the market to take market share from an incumbent on an existing route.

#### Overall conclusion on prospects for new entry

- 5.48 Our view is that the prospects for new entry into this market are slim, particularly for vehicle ferries. This is because barriers to entry exist which would make it difficult for a new entrant to access port facilities on the island. We also note that there may be insufficient demand to support more services than are currently being supplied. This implies that the barriers that exist may make it more difficult for a challenger to displace one of the incumbents. We do not believe it is the case, that absent the barriers to entry associated with port facilities, the island would necessarily be served better if there were significantly more operators.

## 6 PERFORMANCE INDICATORS

6.1 In this section, we consider a range of performance indicators for the cross Solent services and assess whether these are commensurate with those of a competitive market which is working well for consumers.

6.2 In its guidance on making a market investigation reference, the OFT has detailed the following on how it will apply the reference test:

'The OFT will consider any available and reliable information on the dynamics of prices, profitability and other performance indicators in its assessment of the case for a market investigation reference. However, the OFT is aware of the limitations of such indicators in yielding useful information about the state of competition in a market.'<sup>75</sup>

6.3 Below, we consider pricing, service quality (including frequency, capacity, speed, reliability, and punctuality and consumer satisfaction) and profitability. We also examine the concerns raised by Andrew Turner, MP, that the recent high acquisition prices and increased debt of Red Funnel and Wightlink may have knock-on effects for ferry customers.

### Pricing

6.4 One of the main concerns expressed during the study was that tickets were too expensive. Island residents felt it was expensive to leave the island either as a foot passenger or with a car. Some hoteliers felt that high fares for guests travelling to the island by car were making the island less attractive compared with other tourist destinations on the south coast of England. A concern was also expressed that prices were not transparent.

6.5 Our analysis of pricing is structured as follows:

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<sup>75</sup> See paragraphs 24.2 to 4.7 of OFT 511, Market investigation references at [www.offt.gov.uk/shared\\_offt/business\\_leaflets/enterprise\\_act/oft511.pdf](http://www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft511.pdf)

- first, we describe pricing structures – both the discounts historically offered to island residents, and the recent shift in the operators' pricing policy towards a yield-management approach
- second, we assess by how much prices have risen in recent years, both in terms of headline prices and in terms of average price/journey (known as yield)
- third, we consider whether prices on the cross Solent routes are high relative to prices of ferry services elsewhere in Europe
- fourth, we consider price transparency.

## Pricing structures

6.6 Both Wightlink<sup>76</sup> and Red Funnel<sup>77</sup> have changed their pricing practices.<sup>78</sup> Previously, each firm would publish a list of prices for return tickets at different times of the year and these prices would tend to be fixed from the time they were published (typically six months in advance) before the date of travel. Passengers tended to use the booking systems less frequently. If booking was necessary, for certain types of ticket, we understand there was no or a nominal penalty for booking and then cancelling or not turning up. Passengers could see in advance how much it would cost to travel at different times of the year and could plan when to make journeys accordingly. If they ended up booking or travelling at the last minute, they knew what price they were going to pay based on the published schedule.

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<sup>76</sup> Wightlink has told us that it has recently introduced a system that can price each leg of the journey separately. The system is now live in their call centre and will go up on their website later this year.

<sup>77</sup> Red Funnel changed its pricing structure from a published tariff price to a fluid pricing structure in 2004.

<sup>78</sup> Hovertravel introduced a new ticketing system in May 2009. It has told us that this has enabled it to deliver further promotional and tactical offers.

- 6.7 However, the old pricing system had some disadvantages for the ferry companies. In particular, they could not ensure that efficient use was made of the onboard space they had available. If a day turned out to be not very popular (for example, because the weather was poor), then fewer people would book or travel on that day and the ferries would have spare capacity. By contrast, if a day turned out to be more popular than originally envisaged by the pricing schedule, there was a risk that too many people would try to book or travel. This would create logistical problems<sup>79</sup>, particularly with the marshalling of waiting vehicles, and cause passengers to have to wait for extended periods. Partly in response to such problems, the Cross Solent Movement Study recommended ticket price differentiation to promote off peak travel during peak periods.<sup>80</sup>
- 6.8 The ferry operators (in common with travel operators in other sectors such as airlines) have now adopted or are about to adopt systems that make pricing more responsive to the demand for a particular sailing rather than the average demand for that time of year or even that day. The operators are encouraging advance booking for peak periods so that passengers decide, on the basis of availability, cost and their own degree of flexibility, when they would like to travel.
- 6.9 If a sailing is not proving very popular, yield-management booking systems automatically reduce the price to encourage more people to use that particular sailing. However, if a sailing is proving to be popular, then the price will rise. For someone who needs to travel, this will have the advantage of making it less likely that the sailing will be fully-booked. However, it will also mean that that service becomes more expensive.

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<sup>79</sup> See, for instance, Cross Solent Movement Study prepared by MVA for The Isle of Wight Council in 2006 at paragraphs 4.3.19 and 4.3.29 as examples of potential logistical problems.

<sup>80</sup> Cross Solent Movement Study prepared by MVA for The Isle of Wight Council in 2006 paragraph 7.4.5

- 6.10 The fare for a popular day will often be relatively cheap when it is first published about six months before the date of the sailing. Some of these advanced fares or lead-in rates have stayed constant for many years. However, we understand they are rarely used, with most passengers only booking in the last month or two before travel.
- 6.11 We note that tourists may benefit more than islanders from the lower fares available for advance bookings. Tourists are likely to be making a significant time and financial commitment, such as booking an annual holiday, which may be planned in advance. Islanders are more likely to travel to the mainland spontaneously or at short notice.
- 6.12 However, islanders benefit from a series of discounts from the ferry operators. The high speed foot services provide discounts for day return tickets which originate from the Isle of Wight. Hovertravel offer a 19 per cent discount (£10.90 compared to £13.40) on a mainland day return rate (for individual or family tickets). The Fastcat service offers a similar day return rate (£11) which represents a 23 per cent discount on the mainland rate (£14.20). The Red Jet service gives a nine per cent discount (£16.80) off the normal Southampton day return fare (£18.60).<sup>81</sup>
- 6.13 Wightlink's vehicle ferry offers a 4 per cent discount (£11 compared to £11.40) but Red Funnel does not offer a discount off the roll-on roll-off day return.
- 6.14 However, for car rates, Wightlink offers island residents Multilink tickets which provide 30 returns for £945 and therefore cost £31.50 each (these tickets are valid for 12 months). These are much better value than the standard returns for mainlanders of 20 returns for £1451 or £73.55 both of which can only be used for 6 months. Wightlink also advertises

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<sup>81</sup> We have been told that Standard Senior and Child Fares are also cheaper for Island residents than mainland residents, off peak midweek prices start at 09:15 for islanders but 18:00 for mainland customers. Islanders (but not mainlanders) qualify for a 'youth' £8.00 off peak return fare.

'Resident vehicle fares' which give fixed day and period return rates for different dates (but not for light vans). The complex pricing makes estimation of equivalent mainland fares difficult.

- 6.15 Red Funnel does not appear to explicitly offer any regular vehicle discounts to islanders. However, we have been told that Red Funnel offers discounted return fares to Island Club members of £43.20 (unrestricted dates) and £35.80 (restricted dates) if buying 25 return journeys at once (costing £1,080 and £895) respectively. Red Funnel has confirmed that, although Island Club membership is available to mainland and island residents alike, the majority of the membership (for Red Jet and roll-on roll-off) is based on the Isle of Wight where demand for frequent crossings is highest.

#### Price increases in recent years

- 6.16 Changes in pricing structures make it difficult to draw firm conclusions from comparisons of the cost of the same journey at different points in time. Under a yield-management approach, if a customer experiences an increase in the price of a certain sailing at a certain time of year, it may be because it was booked later, or the sailing proved more popular than the previous year. Also, a relatively small time difference such as travelling at 11.00 rather than 09.00 could affect the price significantly. It is simply not feasible for the purposes of this type of study to look at all possible price and time combinations to make an assessment of what has happened to individual fare movements. We have looked at some specific fares, as below, but overall our analysis has focused primarily on average price levels.
- 6.17 Many of the complaints about the level of prices came from island residents who wanted to take a car across the Solent. One ticket price which can, in theory, be compared across time is the price for Wightlink Multilink car tickets for island residents. In 2004, 50 returns cost £1,339 or £26.78 per return. In 2008, a maximum of 20 Multilink car return tickets could be bought at the same time. These tickets cost £660 or £33 per return. This increase in the cost of a return ticket is about 23 per cent, which is more than inflation (RPI) has risen in this

period (about 15 per cent). However, the 20-ticket book in 2008 may be considered more comparable with the 25-ticket book in 2004, which cost £746 at an average price of £29.84. If this were the base for comparison, the price would have risen by about 11 per cent, which is less than inflation.<sup>82</sup>

6.18 In this example, the price for a similar purchase has not risen by more than inflation. However, Wightlink has removed an option of purchasing an even bigger book of resident return tickets at a larger discount which some residents will have valued. For the group of customers who used to purchase the 50 ticket books, therefore, prices have risen faster than inflation.

6.19 The cost of Wightlink's books of standard returns<sup>83</sup> has increased by about twice the rate of inflation since 2000-02. This is perhaps to be expected – flexible tickets which can be used at peak times have become more expensive.

6.20 In order to assess whether, overall, the operators have steadily increased charges, the OFT has instead focussed on the average revenue per customer trip (known as yield). Chart 6.1 presents the information we have received on average yield increases in recent years. We have indexed this yield information to the 1990 yields presented in the 1991 MMC report, to show how overall prices have moved since the date of the last full investigation.<sup>84</sup>

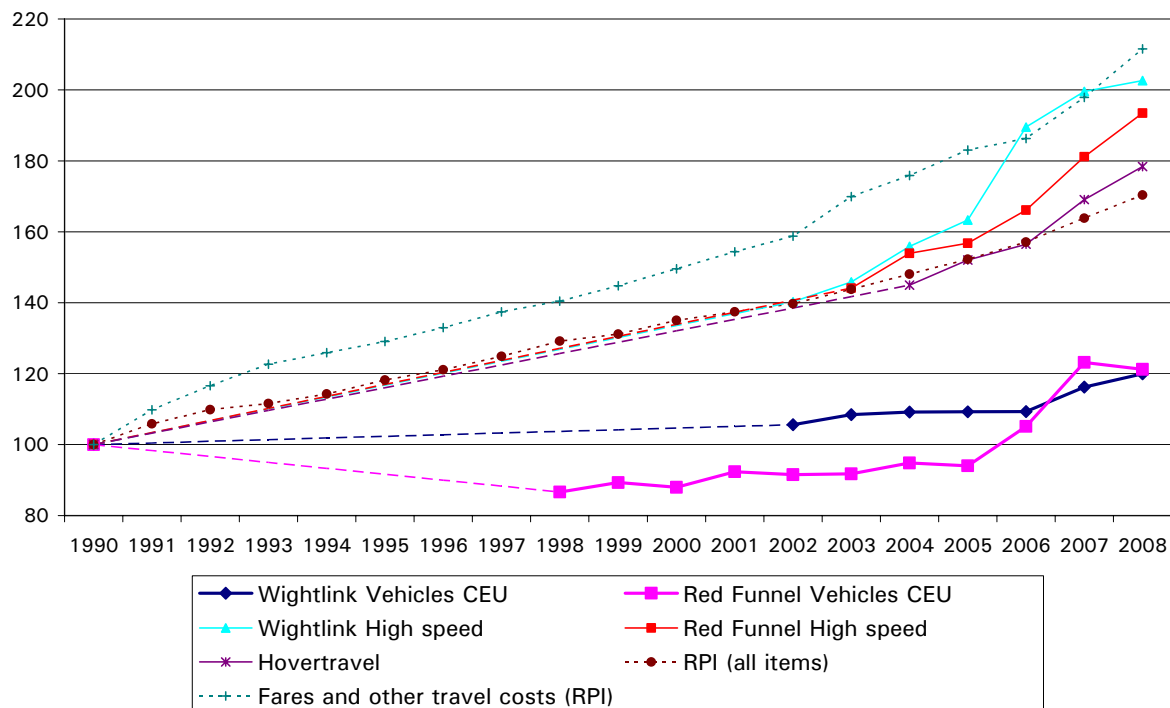
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<sup>82</sup> The OFT notes that, since the beginning of the year, Wightlink has offered 30 Multilink tickets for £945.

<sup>83</sup> Standard returns are more expensive than Multilink tickets but can be used by non island residents.

<sup>84</sup> The 1990 data may not be directly comparable with the information recently provided to us by the operators - for example, there may be differences in the way that freight and coach volumes are converted into CEUs. Nonetheless, we are confident that these data issues are not significant enough to affect our overall conclusion.

Chart 6.1: A comparison of the ferry operators' average revenue per customer trip and relevant indices



6.21 Chart 6.1 shows that the average yield on the vehicle ferries has increased by less than the rate of inflation since 1990. Retail prices have risen by about 70 per cent over this period, while average yields (on a CEU basis) have risen by significantly less for both Red Funnel and Wightlink. Yields on the passenger-only routes have increased at a greater rate, particularly in recent years.

6.22 While the chart indicates that overall vehicle yields have increased more rapidly in recent years, particularly for Red Funnel, this includes the effect of changes in freight rates. Average yields for car passengers have, for both operators, increased by less than RPI since 2002.

6.23 Furthermore, it is arguable that the RPI index may be too strict an indicator to use. Many price indices, which appear more closely related to ferry services, have risen at a faster rate - for instance the RPI basket on 'fares and other travel costs', which is also shown on the chart above. It is also worth noting that oil prices increased sharply between

2003 and 2008. The fast foot passenger services (catamarans and hovercraft) are more fuel-intensive than the vehicle ferries, which may account for the steeper price rises for foot passengers in recent years.

- 6.24 Another complaint put to us was that the cost of other services (notably food and parking) offered by the ferry companies had also increased significantly in recent times, and should be taken into account when considering how far average revenues had increased over time. We found that non-ticket revenue is the equivalent of less than 10 per cent of Wightlink's ticket revenue, and that over 80 per cent of this revenue is from food. For Red Funnel, with its longer crossing and greater opportunities to sell food, non-ticket revenues are larger, reaching 17 per cent of ticket revenues in 2008. However, given that the longest journey is less than one hour, it is hard to argue that the ferry companies have significant market power in respect of food sales, so we do not consider this to be a particularly important part of the overall picture.
- 6.25 In general then, we found that the increase in average yields since the MMC investigation has not been out of line with either general inflation or more specific indices of relevant costs. We recognise that some particular ticket prices have increased faster than the rate of inflation, but this has been offset by greater use of special discounts. We view this as part of an overall shift in pricing policy designed to deal with peaky demand.

### Comparisons of prices across markets

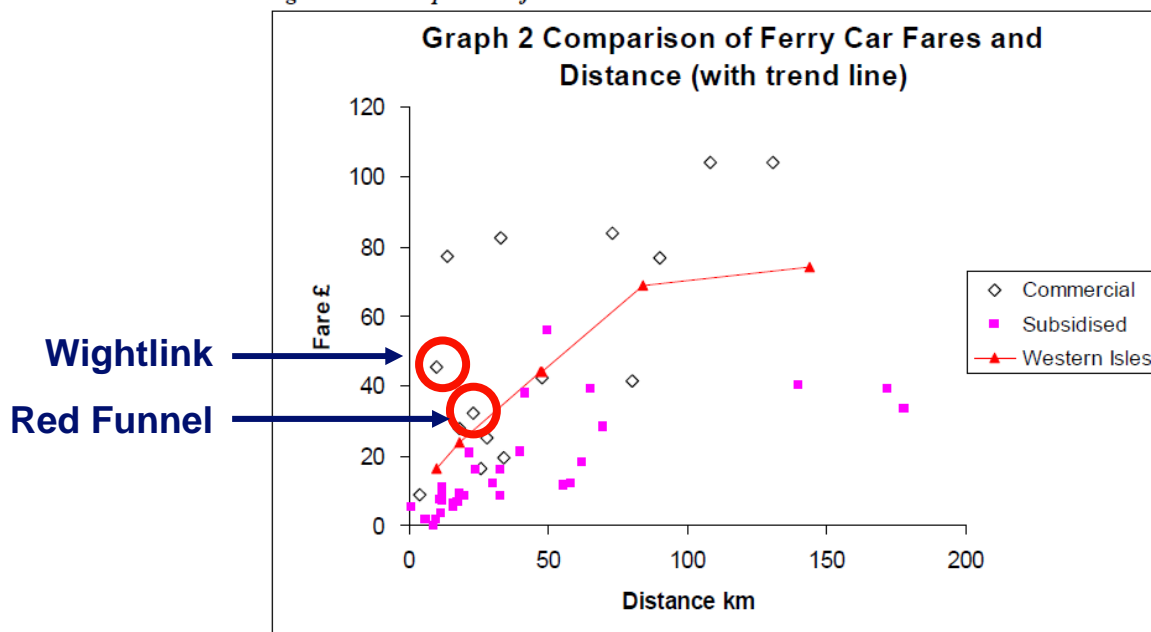
- 6.26 It was put to us that cross Solent fares were among the most expensive in Europe. However, we received no concrete evidence in support of this assertion.
- 6.27 Fare comparisons are extremely difficult, with a large number of factors affecting the cost of a crossing including crossing length, the type of water and the frequency of the service and the average utilisation. Absolute costs do not reflect the length of journey, yet per-mile costs may also be misleading, since on a short crossing the cost of port

facilities and the time taken to load and unload is a significant part of the overall cost.

6.28 Nonetheless, a 2004 study by Napier University and Pedersen Consulting did attempt to compare ferry prices across different routes.<sup>85</sup> The following chart, extracted from the report, shows the fares and crossing distances of several European ferry routes using the price of a summer single (peak) fare.

Chart 6.2: Comparison of car fares by ferry operator

Figure 4.5.2 Comparison of Car Fares and Distance



6.29 The cost of the Wightlink and Red Funnel crossings were more expensive than the average crossing in this sample. However, many of the routes, in the sample, were subsidised, so the fare would not reflect all the costs of those crossings which are met by subsidies. Among the purely commercial routes (shown as white diamonds on the above

<sup>85</sup> 'Western Isles Ferry Fares Mechanism Study'- A Report For Comhairle nan Eilean Siar dated 27 June 2006 by McQuaid, Greig, Baird and Pedersen.

chart), Wightlink's and Red Funnel's pricing is not obviously out of line, particularly given the short crossing distance.

- 6.30 One comparison that is often made is with the cost of cross Channel ferries. On a quick comparison of prices for cross Solent and cross Channel, it is not possible to say which is likely to be cheaper. There is a significant variation in prices. When we attempted to undertake a short test of prices we found that on two days cross Channel ticket prices were more expensive and on six days they were cheaper. From this limited exercise it was impossible to draw any concrete conclusions, particularly without considering the interplay between the length of journey, utilisation of the vessels and revenues from alternative sources such as on-board shopping which may impact on the level of cross Channel ticket prices.

### Transparency of prices

- 6.31 Three concerns were put to us as regards transparency of pricing. The first was that customers cannot be certain as to the price they will be charged for a particular journey. We have heard complaints about websites that are confusing or do not show the cheapest rate for a crossing.
- 6.32 Wightlink has told us that its website has lacked the flexibility that customers now seek when selecting travel options.<sup>86</sup> Red Funnel has admitted that its website has not always performed properly in recent years. Red Funnel had an increase in complaints in early 2008 when a new website was introduced to make prices and the options for different sailings more visible. This website apparently had several faults, though these have now been resolved. Indeed, we have been told that the Red Funnel website has markedly improved recently. Wightlink has told us that it has recently introduced a system that can price each leg of the journey separately. The system is now live in its call centre and will go

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<sup>86</sup> Wightlink has told us it is investing £2million in a new website to offer more options, flexibility and functionality

up on their website later this year. Wightlink informed us it expects that this will provide a 'noticeable increase in the transparency of [Wightlink's] fare structure'.<sup>87</sup>

- 6.33 In our view, these developments should do much to address customer concerns. However, the fact that these developments have been somewhat slow in coming (relative to other operators in the travel sector) perhaps indicates a lack of competitive pressure on service standards.
- 6.34 The second complaint was that prices change for different sailings, and can change quickly if, for example, good weather causes an increase in bookings. Some residents have said that pricing like this, which works similarly to a low-cost airline, is not appropriate for a lifeline ferry service which is the only means of travelling from the Isle of Wight.
- 6.35 Our view is that the introduction of yield-management systems, which spread demand for different sailings and charge higher prices for peak fares, are commercially efficient for the ferry operators and are not in themselves suggestive of competition problems. As noted above, there should be benefits to the market in terms of better utilisation of services and increased availability in the peak period and lower prices in non-peak periods.
- 6.36 The third complaint was that the ferry operators were not transparent in their dealings with business customers, particularly hoteliers who purchase ferry tickets on behalf of their guests as part of a package deal. We were told that it is a condition of bulk discount deals that they do not disclose the terms to other hoteliers on the island. It was alleged that special offers were not made on an equal basis to all hoteliers and that this was distorting competition in the hotel trade.
- 6.37 Our view is that a degree of price discrimination between hoteliers is to be expected – different hotels may be in different bargaining positions as

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<sup>87</sup> Wightlink's April 2009 submission, paragraph 3.2.2 on page 19.

regards the ferry operators. We understand that the ferry operators have no direct stake in the hotel sector and therefore do not stand to gain by unfairly advantaging or disadvantaging any one group. Commercial confidentiality is common in business negotiations and we do not regard it as an indicator of competition problems.

### Collusion on prices

- 6.38 Some respondents have said that the tendency for the ferry companies to have similar prices is evidence of collusion - that is: an agreement (tacit or otherwise) that the companies would charge similar prices and not try to undercut one another. Similar prices for similar services does not amount to evidence of collusion. We have not seen any evidence which points towards collusion between the ferry operators.

### Conclusion on pricing

- 6.39 Taking the evidence in the round, it is not clear that overall price levels are far out of line with where they should be in a reasonably well functioning market. On average, price rises since the 1991 MMC enquiry have not been inordinate. The evidence does not indicate collusion between operators. It is difficult to assess how cross Solent prices compare with other routes but we have not found concrete evidence to support the assertion that they are the most expensive in Europe.
- 6.40 However, we acknowledge that some islanders may have experienced steeper than average price rises in recent years as a result of the shift to a dynamic pricing approach. While islanders can, of course, benefit from the lower prices available to those who book in advance and are flexible about travel times, we recognise that these offers will generally be more attractive to tourists planning holidays than to residents wishing to leave the island at short notice.
- 6.41 Set against this, we recognise that the ferry companies offer significant discounts to island residents. While, in some cases, these have been reduced in scope in recent years, they nonetheless remain a significant benefit to islanders. We note that a perfectly competitive outcome would

not necessarily involve discounts specifically for islanders – it may be only because the ferry companies can recoup the costs from tourists and other users that specific discounts for islanders are available.

6.42 On balance, therefore, we regard the shift in pricing approach as indicative of an increase in competition rather than the opposite, and do not regard dynamic pricing as being against consumers' interests.

6.43 On price transparency, we believe that the ferry companies are taking steps to resolve many of the problems which customers have complained about with booking systems lately. This issue aside, we do not believe that there is a problematic lack of transparency in this market.

### Service quality

6.44 The Complaint from Andrew Turner MP was supported by more than 8,000 individuals and businesses. This suggests that a large number of consumers are not happy with the services being provided by the ferry companies. In addition to pricing, the main issues identified in the MP's submission were:

- the quality of services (both on-board and at terminals)
- timetable issues (frequency and punctuality of services) and
- Wightlink's introduction of new ferries on the Lymington – Yarmouth route.

6.45 The MP received very few positive comments about the ferry operators. We note also that the MP also did not receive many complaints or comments about Hovertravel.

6.46 Below, we review the evidence on complaints and customer satisfaction, frequency, capacity, speed and reliability.

## Complaints and customer satisfaction

- 6.47 We asked for complaints information from the main operators. We found that until recently the operators had been responding to complaints on an ad hoc basis and did not have systems for analysing complaints received. Consequently there was little complaints data to analyse.
- 6.48 However, Wightlink now collects complaints data, and we have obtained this for the last two years. While this is not sufficient from which to draw strong conclusions, it does provide an overall picture of complaints received recently.
- 6.49 In 2008-09, Wightlink received 947 complaints (out of 4,853,152 passengers who sailed in 2008/09). The top three issues being complained about in the 2008-09 period were:
- fares<sup>88</sup> (32 per cent)
  - customer services (16 per cent)
  - staff (13 per cent).
- 6.50 In 2007-08, 889 complaints (out of 5,358,205 passengers who sailed in 2007/08) were received. The main subject of complaint in this period was also fares.
- 6.51 Wightlink has informed us that it has been undertaking customer satisfaction surveys since 1999.<sup>89</sup> The Wightlink customer satisfaction surveys address issues such as punctuality, frequency of departures, speed of crossing, reliability, cleanliness, helpfulness of port staff and on-board staff. Wightlink assured us that they have typically found that

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<sup>88</sup> Fares cover a wide variety of issues. For example 12.6 per cent of complaints relate to 'cost', 6.1 per cent to 'offers', 4.4 per cent to 'cancellation policy' and 3.3 per cent to 'fuel surcharges'.

<sup>89</sup> Since 2005 it has also established a customer charter.

'overall a good level of service is being delivered' and that it 'met expectations'.<sup>90</sup> Customers originating from the mainland generally scored the services higher than customers' resident on the Isle of Wight.

- 6.52 Hovertravel has not carried out or commissioned any professional customer surveys over the period to assess consumer satisfaction with the services that they provide. We have been told that Red Funnel used a third party to carry out a comprehensive survey of all 55,000 Isle of Wight households in 2006. Since 2006, we have been advised that it has only carried out ad hoc quantitative surveys to gauge responses to specific issues.
- 6.53 It would appear to us that all of the operators provide a basic level of service on board their vessels and at their terminal facilities. The roll-on roll-off vessels all supply food and beverages, vending machines, Wi-Fi access and toilet facilities, while the passenger ferries provide less food and drink services. Given the relatively short duration of the crossing, particularly for the hovercraft journey between Ryde Esplanade and Southsea, we would not necessarily expect the operators to provide premium quality services as might be the case on vessels undertaking longer crossings to the continent or even further afield.
- 6.54 All of the submissions received from the operators suggest that there has been investment to improve the quality of service being provided. Wightlink's submission to the OFT states that it has invested significantly in upgrading its fleet and improving customer service standards over the past three years. In particular, it has invested £26.7 million in new ferries which have recently commenced operating on the Yarmouth to Lymington route and £9.9 million in new catamarans which will enter into service on the Ryde - Portsmouth route this Summer. In addition, a further £7 million in total, some of which has already been spent, has been allocated to further developing the infrastructure and facilities at all Wightlink's terminals. Further, Wightlink have advised us that it is proposing to invest approximately £16 million on the

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<sup>90</sup> Wightlink's April 2009 submission, Annex C paragraph 5.5.

Fishbourne-Portsmouth route. Finally, as discussed under price transparency above, Wightlink's upgraded online booking facility is expected to commence operation shortly.<sup>91</sup>

- 6.55 However, against this we note a comment in one of the documents associated with MEIF's acquisition of Wightlink to the effect that 'The dominant position of WSL [Wightlink] and the relatively low level of competitive forces in the cross-Solent market may extend the "competitive" lives of the vessels, but MSS has noted areas where the older vessels will require increased expenditure'.<sup>92</sup> This suggests that competitive pressure on quality of service is not particularly strong and perhaps that new investment is driven primarily by other factors, for example the need to control operating costs, which are higher on older vessels.
- 6.56 Red Funnel comments in its submission to the OFT that its innovations include the introduction of a: 'significant array of discounted offers; introducing new on-line booking systems; offering customers a complete food and beverage service'<sup>93</sup> and that, in prospect, has further (unspecified) developments that will be of benefit to its customers.
- 6.57 Hovertravel has said that it has made significant investments in both the Ryde and Southsea terminals, linked to the introduction of its new ticketing system. Hovertravel has explained that the new facilities range from upgrading the ticket desk to more customer friendly boarding lounges. We understand, toilet facilities at both terminals have been upgraded, vending machines and literature points enhanced with the aim of providing an overall more enjoyable customer experience.

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<sup>91</sup> Wightlink has informed us that this is a £2 million investment.

<sup>92</sup> Paragraph 3.2.2 of the Project Oberon document.

<sup>93</sup> Red Funnel submission dated 27 March 2009, paragraph 3.1 on page 19.

6.58 Overall then, there clearly has been new investment in vessels and terminal facilities on the cross Solent routes in recent years. However, it seems likely that many of the Isle of Wight's residents would consider this investment not before time, and we have not observed the dynamism in providing new and improved facilities to customers which we might expect to find in a more competitive market. For example, we observe that some of the vessels currently operating on the cross Solent routes are coming to the end of their operating life and consequently look very tired and worn (for example, Wightlink's Our Lady Pamela and Red Funnel's Red Jet 1 and 2 (recently sold<sup>94</sup>)). Further, it is not clear that the facilities presently on offer meet the expectations of passengers or fully reflect the higher standards of service which might be expected in a more dynamic and competitive market environment.

6.59 Moreover, we note that two out of the three operators have not carried out any substantive customer satisfaction surveys for three years. This may suggest that cross Solent operators have had more of a 'take it or leave it' attitude to their customers than would be expected in a more vigorously competitive market. It is clear from the support behind the complaint that this is an area where more work remains to be done by the ferry operators to sharpen their offering to customers.<sup>95</sup> Improvements such as modern flexible booking systems, effective communication in respect of pricing and fresh craft, coupled with a manifest customer service culture and tangible sensitivity to the position of islanders may well help in this regard given the complaints we have seen.

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<sup>94</sup> [www.redfunnel.co.uk/corporate-information/media-and-pr/latest-news/news-release-14-05-2009](http://www.redfunnel.co.uk/corporate-information/media-and-pr/latest-news/news-release-14-05-2009)

<sup>95</sup> In this regard, we note that the Guardian newspaper produces annual travel awards based on a survey of readers. In 2008 in the 'Best Ferry company' category Wightlink came 15<sup>th</sup> out of 18 Ferry operators (in 2007 it had been eighth out of 15 operators) while Red Funnel came eighth (in 2007 it had been 11<sup>th</sup>).

## Frequency, capacity, speed and reliability

6.60 It was put to us that the level of service provided is on a downward trend. In this regard, we have examined the frequency, capacity, speed and reliability of the service to obtain an all round picture of what is happening to the level of service.

### Frequency

6.61 The Wightlink and Red Funnel services operate all year round, through the day and through the night on their roll-on roll-off ferries (since 1999/2000). Hovertravel operates all year round from early morning into late evening only, because the terms in its lease subject it to noise related restrictions overnight and in the very early morning.

6.62 Figures supplied by Red Funnel (but covering all three operators) indicate that, for foot passengers, there is a ferry leaving the Isle of Wight approximately every 8 minutes on average. For passengers travelling with a vehicle, a ferry leaves the Isle of Wight on average every 18 minutes in the summer months, dropping to 24 minutes in the winter months. Scheduled departures are shown in the Figures below.

Figure 6.3: Summer departures from Isle of Wight

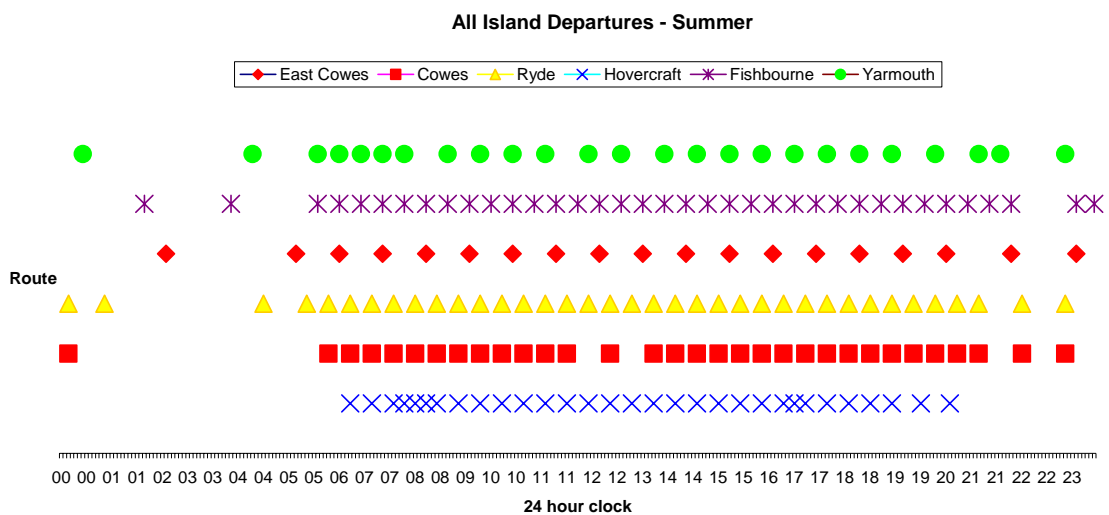
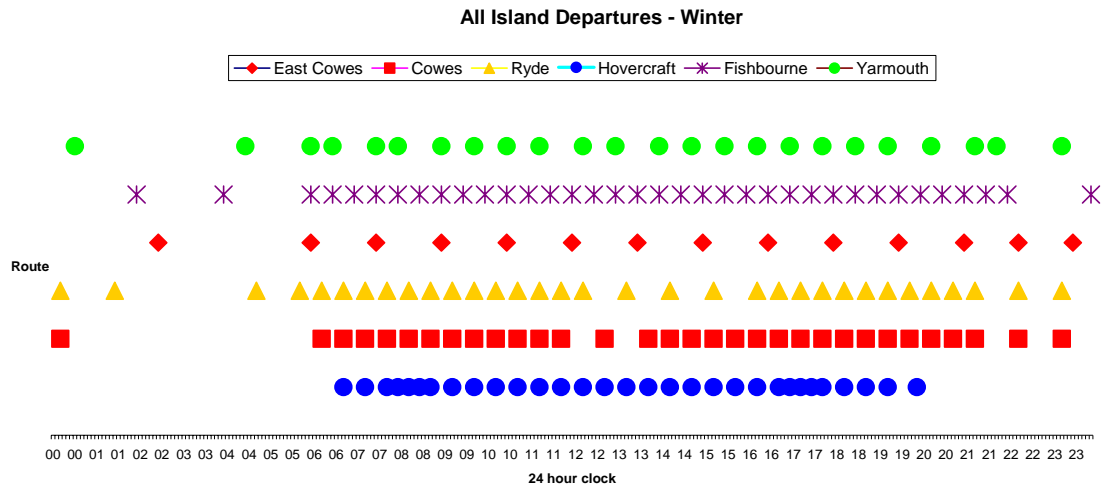


Figure 6.4: Winter departures from Isle of Wight



6.63 Chart 6.5 shows that there has been a significant increase in Wightlink’s number of sailings over the period since 1995. For Red Funnel and Hovertravel, we obtained frequency information for a more recent period only - this is shown in Chart 6.8 below.

Chart 6.5: Wightlink – frequency of sailings over time

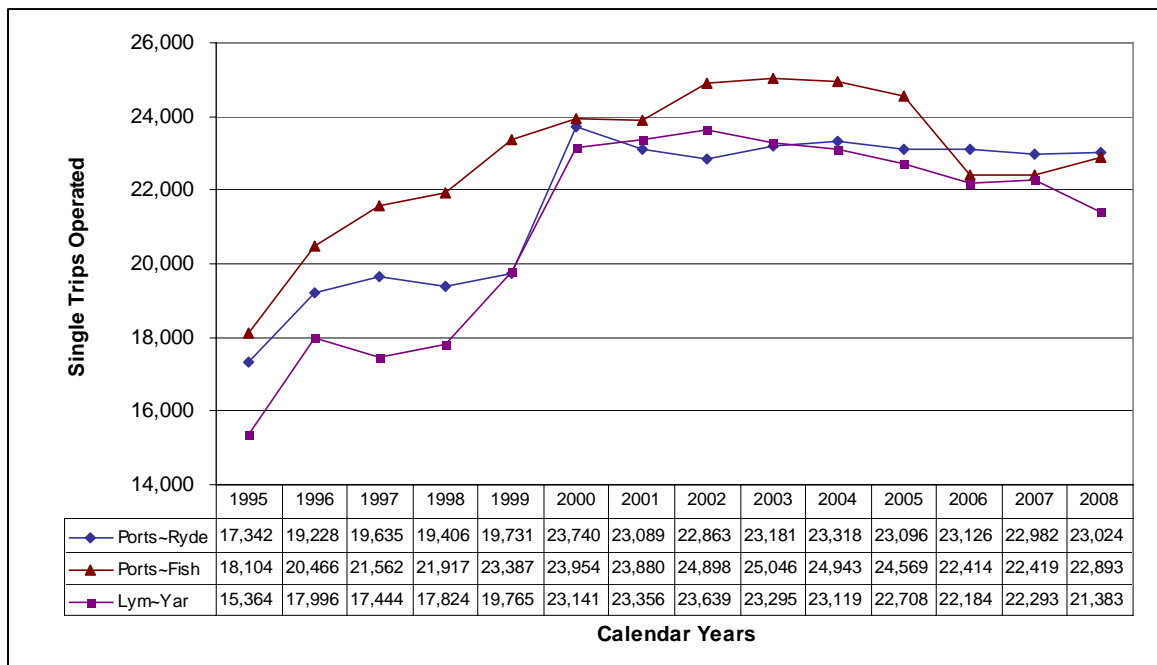
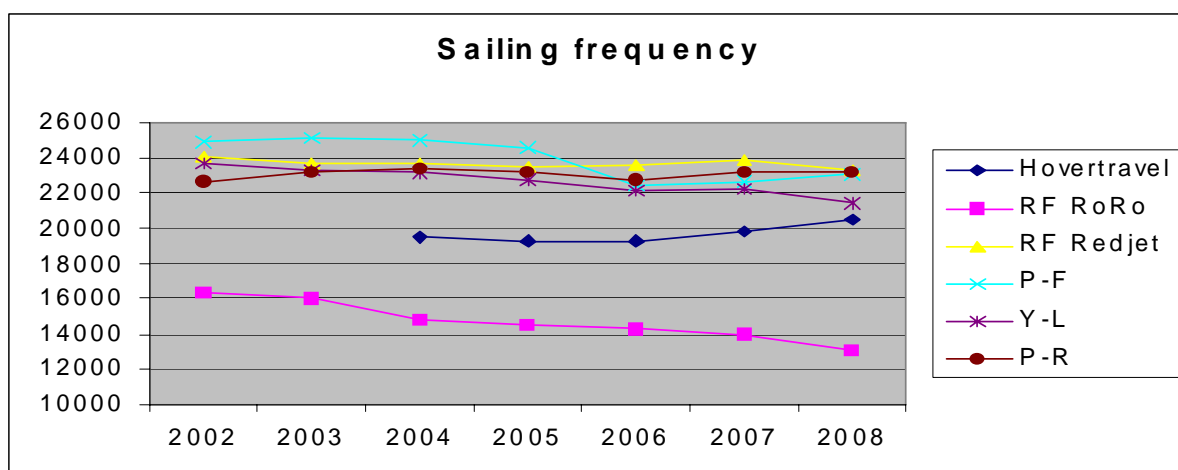


Chart 6.6: All operators - frequency of sailings since 2002



Source: OFT (from figures supplied by operators)

6.64 While Hovertravel has increased its number of sailings year on year, Red Funnel and Wightlink have reduced their overall number of sailings from what was, in Wightlink's case at least, the peak level in 2002/03. We note that the frequency of sailings between Lymington and Yarmouth is likely to be lower again for 2009 because of timetable changes and operational issues with the introduction of new ferries on the route.<sup>96</sup>

6.65 We believe the frequency of sailings is likely to fall further in future years. Red Funnel's 2009-2012 business plan shows that number of sailings planned is likely to be less than that for 2008 (down from 13,044 to 12,700 on the Southampton to East Cowes routes and down from 23,283 to 22,600 on its West Cowes to Southampton Red Jet service).<sup>97</sup> Furthermore, Wightlink has just reduced the number of

<sup>96</sup> See, for instance, [www.iwcp.co.uk/news/news/ferry-problems-were-a-bit-of-a-fag-26035.aspx](http://www.iwcp.co.uk/news/news/ferry-problems-were-a-bit-of-a-fag-26035.aspx)

<sup>97</sup> Red Funnel has informed us that while it is likely to stick to its plan with regard to the East Cowes-Southampton route, it has increased sailings on the Red Jet with the re-instatement of the four lunchtime sailings which had been cancelled in 2008 as a result of the high fuel prices at the time.

weekday sailings on the Ryde to Portsmouth route from 38 to 34 (a 10 per cent service reduction) from April 2009.<sup>98</sup>

- 6.66 Overall then, we found that the frequency of services has increased significantly over the period since 1991, at least for Wightlink, although it has come down slightly in recent years for Wightlink and Red Funnel. Both Wightlink and Red Funnel have told us that they are committed to maintaining a comprehensive, year round service, and it is clear that Isle of Wight residents value this. On balance, it appears to us that the Isle of Wight still receives a good level of service in terms of the overall frequency of sailings.

### Capacity and utilisation

- 6.67 All the ferry operators have, over time, continued to invest in the vessels in their fleets.
- 6.68 Hovertravel has invested in the Solent Express, a hovercraft built in 2006, which can carry 134 passengers.<sup>99</sup>
- 6.69 Red Funnel has stretched each of its roll-on roll-off vessels (Red Osprey, Red Falcon and Red Eagle) to accommodate more vehicles (see Chart (4.4)). Red Funnel has doubled the capacity on its Red Jet route (West Cowes to Southampton) with the introduction of Red Jet 3 and Red Jet 4 in 2003. These capacity increases are shown in the chart below. Red Funnel has recently sold Red Jet 1 and 2 which will be replaced by Red Jet 5 in July 2009.<sup>100</sup> Red Jet 5 can carry 187 passengers and is therefore bigger than Red Jet's 1 and 2. We have been told that although Red Jet's 1 and 2 combined capacity is greater than Red Jet 5,

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<sup>98</sup> We have noted a complaint that this service has been further reduced to 29 weekday sailings. See [www.iwcp.co.uk/news/letters/no-logic-in-timetable-changes-25969.aspx](http://www.iwcp.co.uk/news/letters/no-logic-in-timetable-changes-25969.aspx)

<sup>99</sup> Its two older hovercraft, Freedom 90 and Island Express, can carry 95 passengers each.

<sup>100</sup> [www.redfunnel.co.uk/corporate-information/media-and-pr/latest-news/news-release-14-05-2009](http://www.redfunnel.co.uk/corporate-information/media-and-pr/latest-news/news-release-14-05-2009)

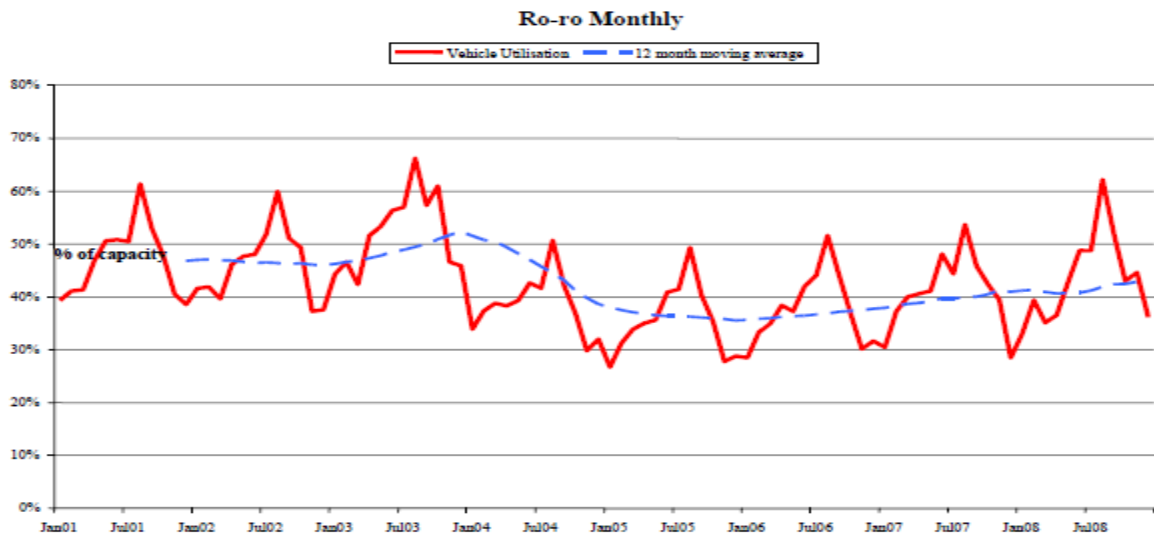
Red Funnel only ever use either of Red Jets 1 and 2 to cover for the larger vessels when they are out of service. In practice, the arrival of Red Jet 5 will avoid the periodic reduction in capacity when either Red Jet 3 or 4 is withdrawn from service.

- 6.70 Wightlink has purchased three new ferries to service the Yarmouth Lymington route which can carry 65 cars compared to the older ferries that could accommodate less than 50 cars. However, we have been told these ferries are currently running at a lower frequency than the previous vessels. Until Wightlink has resolved the issues raised by the Lymington Harbour Authority, it remains unclear what the effect on capacity will be over the medium term. Further, Wightlink have advised us that it is proposing to invest approximately £16 million on the Fishbourne-Portsmouth route and that it also plans to replace the existing catamarans on the Ryde to Portsmouth route in July 2009.<sup>101</sup>
- 6.71 Overall, we have a picture of increasing capacity for Red Funnel and Hovertravel and an unclear picture for Wightlink in relation to the problems on the Yarmouth-Lymington route and when its proposed investment on the Fishbourne-Portsmouth route will come into effect.
- 6.72 Overall utilisation is illustrated in the charts below.

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<sup>101</sup> Wightlink has informed us that these catamarans will be operated to a capacity of 260 passengers when operated with a crew of four. Wightlink say this will result in greater than the normal operational capacity of the existing Fastcats which is 242 passengers when a crew of four is employed.

Chart 6.7: Utilisation of Red Funnel's roll-on roll-off ferries



Source Red Funnel

Chart 6.8: Utilisation of Wightlink ferries

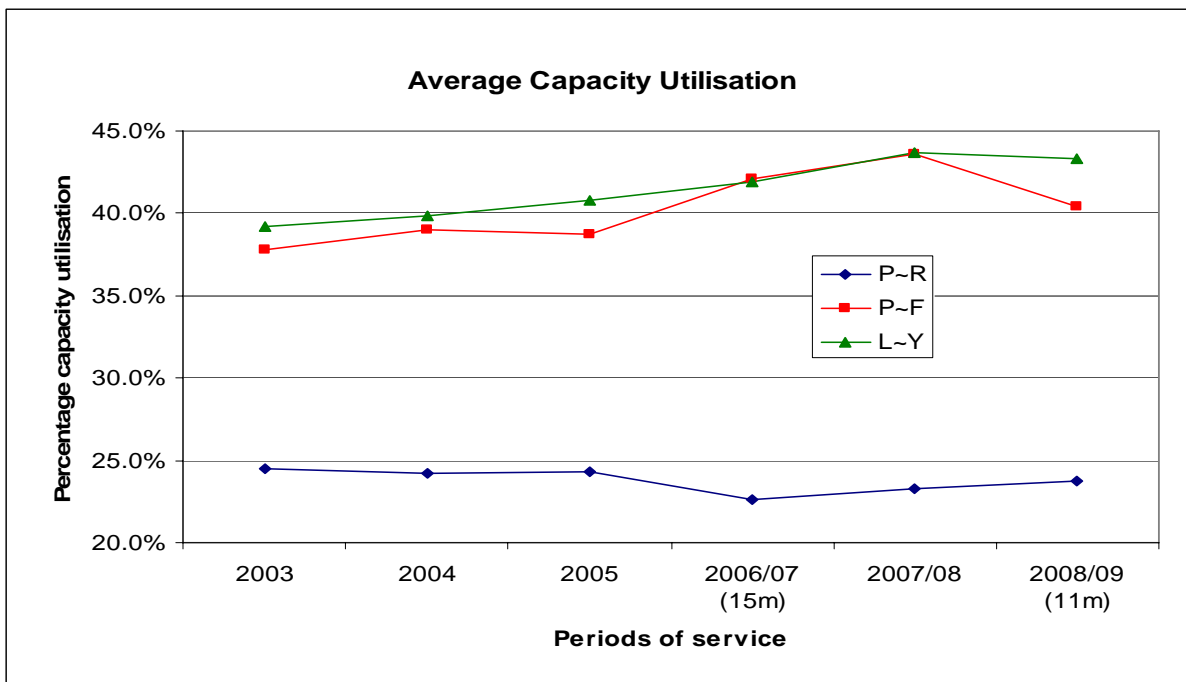
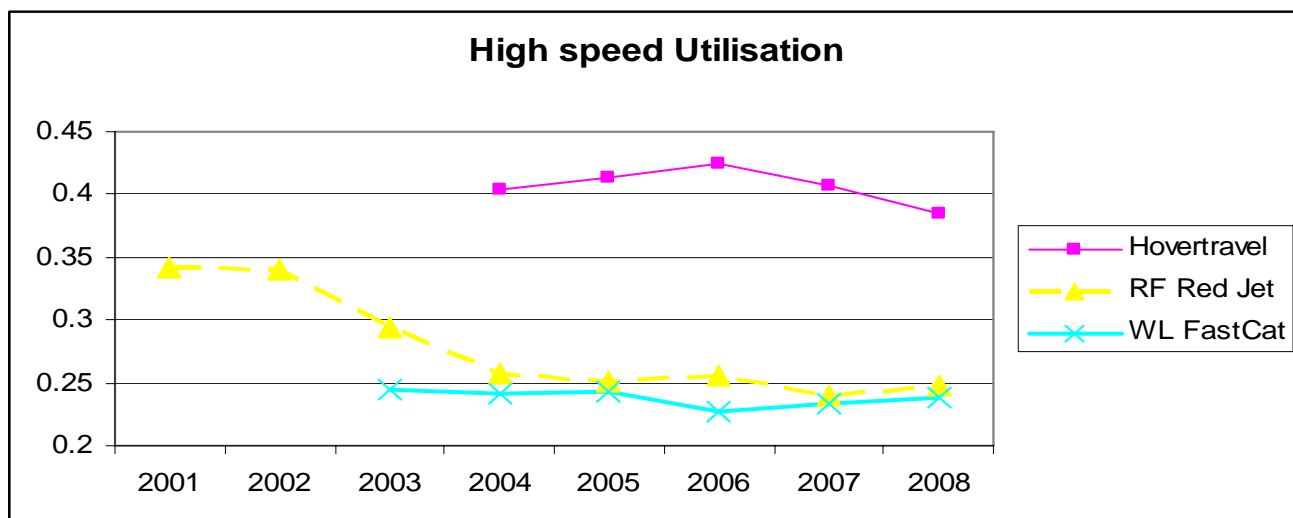


Chart 6.9: Utilisation of Fastcat, Red Jet and hovercraft



6.73 We consider that stable or declining overall utilisation suggests that investment in capacity is keeping pace with growth in demand.

6.74 We also note that capacity utilisation appears fairly low on most routes at most times. This is consistent with the possibility, discussed in Chapter 5, that there may be insufficient demand to sustain competition between two or more operators on most routes.

### Speed

6.75 In terms of speed, there are three hi-speed passenger links between the Isle of Wight and the mainland – the Red Funnel Red Jet service which travels between West Cowes and Southampton, the Wightlink Fastcat service which travels between Ryde pier and Portsmouth and the Hovertravel hovercraft which travels between Ryde Esplanade and Southsea. Of these, the Hovercraft has the advantage of speed taking only 10 minutes to cross the Solent. The Wightlink Fastcat takes 18 minutes to complete its crossing while the Red Jet, which has the longest distance to travel, takes just 25 minutes.

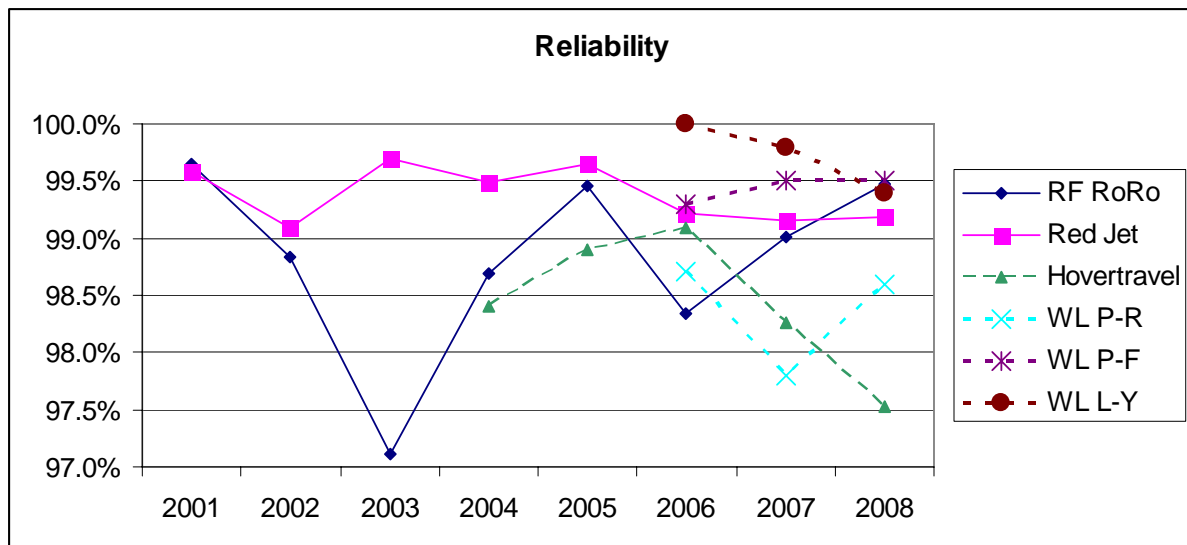
6.76 The roll-on roll-off vessels take longer to traverse the Solent because of their size and the longer turn around time at each end of the journey as

vehicles are loaded and unloaded. However, none of the crossings takes longer than an hour.

6.77 The speed of the connection with the mainland, particularly for foot passengers, appears to be good. We have received no complaints that the crossings are slower than they should be.

### Reliability

Chart 6.10: Reliability figures for the three operators by route



6.78 The main issues which impact on the ferry services' reliability are weather conditions, sea traffic issues, and technical issues. While some of these factors are outside the control of the ferry companies, the operators can, to some extent, control how well prepared they are to react to problems when they arise. While it is difficult to say what level of cancellations and delays is acceptable in absolute terms, it is informative to look at trends over time.

6.79 We have received a number of complaints about the punctuality and reliability of cross Solent ferry services. We have looked at cancellation data for all three operators but only Wightlink was able to supply data on punctuality.

6.80 Table 6.13 below shows that in 2008 Wightlink cancelled less than one per cent of its sailings and that 86.4 per cent of sailings left either on time or less than five minutes after their scheduled departure time. However, we note that punctuality has declined over the last three years, with delays of over 15 minutes duration almost doubling.

6.81 Wightlink have commented in response to this observation that punctuality on the Ryde to Portsmouth route has consistently been around 99 per cent while on the Fishbourne to Portsmouth route 94 per cent of services have left within 15 minutes of the scheduled sailing time. Wightlink has informed us that the overall decline is mainly attributable to the Yarmouth – Lymington route.

6.82 Wightlink notes that, even in terms of overall punctuality across all of the routes they operate, they compare favourably with rail. Red Funnel similarly cancelled less than one per cent of its sailings, as shown in the table 6.12 below.

Table 6:11 Wightlink punctuality and cancellations 2006 – 2008 (all routes)

	< 5 mins	5-10 mins	11-15 mins	> 15 mins	Cancelled
2006	91.4%	3.7%	1.6%	3.3%	0.7%
2007	89.2%	4.6%	2.2%	4.0%	1.0%
2008	86.4%	4.8%	2.7%	6.1%	0.9%

Source: Wightlink

Table 6.12: Red Funnel cancellations 2004 – 2008 (all routes)

	2004	2005	2006	2007	2008
Total sailings	38,126	37,794	37,454	37,514	35,862
Number Cancelled	314	161	426	343	260
Cancelled (as a Percentage of total sailings)	0.8%	0.4%	1.1%	0.9%	0.7%

Source: Red Funnel

6.83 We were told that hovercrafts are more susceptible to technical problems and certain adverse weather conditions than ferries and that as such we could expect to see a higher cancellation rate for Hovertravel. Table 6.13 shows Hovertravel's cancellation rate.

Table 6.13: Hovertravel cancellations 2004 – 2008

	2004	2005	2006	2007	2008
Total flights	19,478	19,280	19,313	19,750	20,461
Number Cancelled	312	212	176	345	505
Cancelled (as a Percentage of total flights)	1.6	1.1	0.9	1.7	2.5

Source: Hovertravel

6.84 Overall, then, the percentage of scheduled departures which are not completed appears to be low and stable. We only have punctuality figures for Wightlink. These show that there has been some decline in punctuality in recent years. We understand, however, that this relates primarily to the problems experienced on the Yarmouth - Lymington route and that Wightlink expects punctuality to return to previous levels shortly.

## Profitability

6.85 In this section we consider the evidence put forward on the profitability of the two operators. We have:

- reviewed the profitability analysis undertaken in previous investigations
- requested profitability information from the operators
- reviewed profitability analysis submitted in support of the complaint by Andrew Turner, MP

- reviewed comparative information available on profitability of other ferry companies.

## Findings of previous investigations

6.86 In 1991, the MMC found that the Return on Capital Employed (ROCE) for Wightlink was likely to have been about 12 per cent in 1990, down from a peak of 15.5 per cent in 1989. The MMC found that in 1990 no profit was being earned on the Ryde-Portsmouth service, but ROCE was about 16 per cent on each of the vehicle ferries. This level of profitability was felt to be 'substantial' but not so excessive as to be against the public interest. The MMC's findings as regards ROCE for Wightlink are reproduced in Table 6.14.

Table 6.14: Wightlink and its predecessors: ROCEs on a net replacement basis

		Total	Portsmouth-Ryde	Portsmouth-Fishbourne	Lymington-Yarmouth
<b>1986</b>					
Capital employed	(£'000)	61,421	18,625	29,885	12,911
Profit before interest and tax	(£'000)	4,078	-488	3,283	1,283
Return on Capital Employed	(%)	6.6	-2.6	11	9.9
<b>1987</b>					
Capital employed	(£'000)	58,799	17,633	28,834	12,332
Profit before interest and tax	(£'000)	5,361	-257	4,058	1,560
Return on Capital Employed	(%)	9.1	-1.5	14.1	12.7
<b>1988</b>					
Capital employed	(£'000)	56,217	16,652	27,787	11,778
Profit before interest and tax	(£'000)	6,475	-515	5,091	1,899
Return on Capital Employed	(%)	11.5	-3.1	18.3	16.1
<b>1989</b>					
Capital employed	(£'000)	53,748	15,739	26,775	11,234
Profit before interest and tax	(£'000)	8,321	-102	5,996	2,427
Return on Capital Employed	(%)	15.5	-0.6	22.4	21.6
<b>1990</b>					
Capital employed	(£'000)	58,977	15,068	33,468	10,441
Profit before interest and tax	(£'000)	6,908	21	5,237	1,650
Return on Capital Employed	(%)	11.7	0.1	15.6	15.8

6.87 OFT monitoring in the 1990s found that Wightlink's overall profitability had declined from the 1990 rate of 12 per cent.

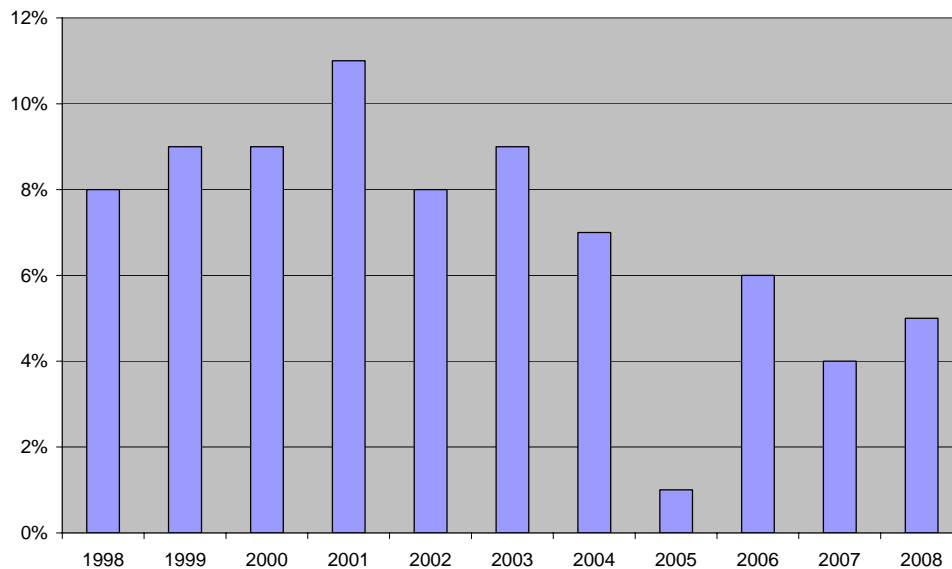
6.88 The 1991 MMC report estimated that Red Funnel had made less than five per cent ROCE in recent years, using a replacement cost of capital approach to valuing the asset base. This broke down into a loss on the vehicle ferry, and a profit on the fast foot passenger service (which, at the time, was facing competition from a new entrant, Cowes Express).

- 6.89 The MMC report did not find profitability for Hovertravel to be particularly high.
- 6.90 In 1991 there was also a fourth operator, Cowes Express, which did not make profits and quickly went out of business.

### Profitability information from the operators

- 6.91 Wightlink and Red Funnel have submitted their own estimates of ROCE in recent years, both claiming to use the same approach as the MMC did.
- 6.92 Wightlink's own estimate of ROCE has been between four per cent and six per cent since 2002. However, a Wightlink due diligence report in 2005 (which we assume used a different approach) said that their ROCE had been 10 to 15 per cent since 1992 and projected that it would rise to 11 per cent in 2006.
- 6.93 The figures that Red Funnel submitted for ROCE are shown in the following chart.

Chart 6.15: Red Funnel's estimated ROCE

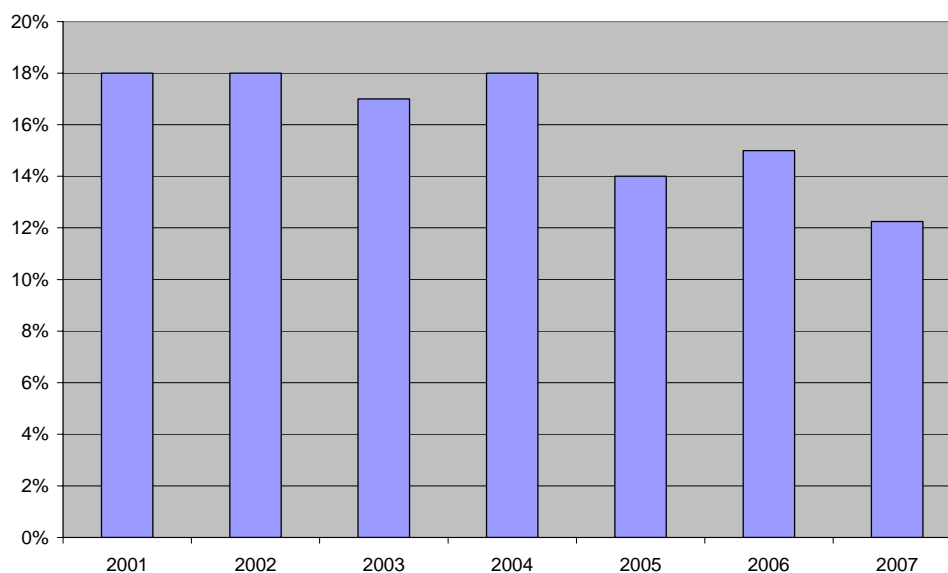


- 6.94 Wightlink's and Red Funnel's business plans both suggest they are aiming to increase profitability slightly going forward from what they regard as underperformance at the present time.
- 6.95 Wightlink's own estimate of its weighted average cost of capital (WACC) is somewhere above 10 per cent (on a pre-tax nominal basis), while Red Funnel estimates its WACC to be around 12 percent (on a post-tax basis).

### Third party evidence

- 6.96 Analysis from a third party presented in support of the complaint by Andrew Turner, MP, suggested that Wightlink had been making a ROCE of up to 18 per cent between 2001 and 2004, though this fell to 15 per cent in 2006. Using the same methodology, we updated the ROCE of Wightlink using primary data supplied by Wightlink for the year ending 2007 and found it was around 13 per cent. These results are shown in the chart below.

Chart 6.16: Third party estimate of Wightlink's ROCE



- 6.97 The third party analysis estimated that the WACC was about 9.6 per cent (on a pre-tax nominal basis) for Wightlink. They point out that the

WACC has fallen significantly since 1992: 10 year yields were around nine per cent in 1992 but by 2007 had fallen to around five per cent. In other words, the return required by a ferry company should have fallen significantly over this period.

- 6.98 The main difference between the third party estimates and Wightlink's own estimates of its ROCE comes down to the approach to valuing the capital base, and in particular the valuation of land.
- 6.99 Our view is that a reasonable regulatory estimate of Wightlink's ROCE in recent years might be somewhere between Wightlink's own estimate and that of the third party.
- 6.100 Using the third party methodology, we also estimated ROCE figures for Red Funnel, and derived estimates of approximately eight to nine per cent for recent years.

### Comparative information

- 6.101 A report by a select committee of the Isle of Man Tynwald compared the profitability of the sole ferry operator for the Isle of Man with that of other ferry operators. The table below shows profitability calculations for 23 ferry lines, mostly European. It shows profit ratio, that is operating profit or earnings before interest and tax (EBIT) as a percentage of turnover. This is a different measure of profitability, based on overall turnover rather than the value of the asset base. The profit ratio for these 23 operators ranges from minus one per cent up to a maximum of 25 per cent, with an average for all operators of 13 per cent. However, we note that different accounting policies across companies and jurisdictions will give rise to results that are not fully comparable.

Table 6.17 EBIT figures for ferry operators

Revenue and Operating Profit of Ferry Companies, 2006-07							(€Euros Million)
Company	Country	Year	Measure	Revenue	Earnings	Profit Ratio	
Bornholmstraffiken	Denmark	2007	Operating profit	71.9	7.1	10%	
Birka line	Finland	2007	Operating profit	105.1	14.0	13%	
Viking Line	Finland	2007	Operating profit	436.0	32.8	8%	
DFDS Passenger	Denmark	2007	EBIT	259.1	13.5	5%	
DFDS RoRo	Denmark	2007	EBIT	493.5	85.6	17%	
Finnlines	Finland	2007	Operating profit	685.5	68.8	10%	
Gotlandbolaget	Sweden	2007	Operating profit	164.5	23.8	14%	
Hurtigruten Group	Norway	2007	Operating profit	481.0	-4.5	-1%	
Tido Sjo (HSD)	Norway	2007	Operating profit	126.3	9.3	7%	
Attica Holdings	Greece	2007	Operating profit	254.3	42.4	17%	
Blue Star Ferries	Greece	2007	Operating profit	168.1	30.0	18%	
Brittany Ferries	France	2006	EBIT	379.4	17.4	5%	
Color Line	Norway	2007	Operating profit	598.7	37.2	6%	
Fosen Trafikklag	Norway	2007	Operating profit	210.1	11.7	6%	
Irish Ferries	Ireland	2007	Operating profit	197.9	41.1	21%	
Minoan Lines	Greece	2006	EBITDA	165.1	27.6	17%	
Mols-Linien	Denmark	2007	Operating profit	107.0	9.1	9%	
TT-Line Co Pty	Australia	2007	Operating profit	97.8	6.9	7%	
Scandlines	Denmark	2006	EBIT	546.9	76.0	14%	
Hellenic Seaways	Greece	2006	EBIT	165.4	10.1	6%	
Wightlink	UK	2007	EBIT	77.4	16.0	21%	
Condor Limited	UK	2007	EBIT	101.7	25.0	25%	
Red Funnel Ferries	UK	2006	EBIT	42.5	7.0	16%	
<b>Average above 23 ferry lines</b>						<b>13%</b>	
<b>Isle of Man Steam Packet</b>	<b>Isle of Man</b>	<b>2006</b>	<b>EBIT</b>	<b>61.4</b>	<b>22.1</b>	<b>36%</b>	

Source: Cruise & Ferry Info, ShipPax Information, Halmstad, Sweden; FAME Database

6.102 From this it can be seen that the profit ratios of both Wightlink (21 per cent) and Red Funnel (16 per cent) are above the average for the sample.<sup>102</sup>

<sup>102</sup> It should be noted that the Select Committee of the Isle of Man Tynwald commented: '[w]e recognised that different accounting policies, particularly with regard to interest and depreciation, and different modes of operation, will give rise to results which are not necessarily fully comparable on a like for like basis.'

## Conclusion on profitability

6.103 Wightlink is the only operator whose level of profitability potentially raises some questions in our view. Wightlink's profitability has continued to be substantial since 1991, particularly in the light of a falling WACC. However, its profitability fell in 2007 and 2008 and is likely to be relatively low again in 2009. Furthermore, the OFT notes the limitations of profitability analysis in providing firm support for conclusions about market power.

## Implications for customers of ownership and financing arrangements

6.104 One concern put to us was that both Wightlink and Red Funnel had been acquired most recently by infrastructure investment funds at high multiples of earnings, and as a consequence of these transactions, were carrying high levels of debt. There was a concern that the financial pressures on the operators had already led, or would lead in future, to increases in prices, reductions in service, or postponement of new investment<sup>103</sup> with knock-on effects on quality of service.<sup>104</sup> Below we discuss:

- the prices at which the two firms most recently changed ownership
- the levels of debt
- the current owners' record of price rises to date, and the likelihood that they would be able to raise prices in future.

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<sup>104</sup> We note that similar arguments have been propounded in certain academic papers such as 'Private Equity and the Culture of Value Extraction' by Julie Froud and Karel Williams (Manchester Business School and Centre for Research in Socio-Cultural Change (CRESC), University of Manchester) and 'The Credit Crunch and Infrastructure Finance', 25 June 2008 by Professor Dieter Helm, New College, Oxford.

## Acquisition prices

- 6.105 The concern expressed was that the acquisition prices appeared high relative to earnings, suggesting that the new owners intended to grow earnings significantly, perhaps through price increases.<sup>105</sup> It was also noted that Red Funnel had changed hands several times in recent years, and that the acquisition price had risen each time.
- 6.106 We have been advised by Wightlink that it was acquired in 2005 for approximately £ [...] million, a multiple of approximately [...] times EBITDA.<sup>106</sup> We have been informed by Red Funnel that it was acquired in 2007 for £ [...] million, a multiple of approximately [...] times EBITDA.
- 6.107 Many infrastructure businesses were acquired for high multiples of earnings before this recession. The stable revenues they generated meant that the risk of default on debt was considered low and the low interest rates on corporate bonds allowed owners to replace equity with cheap debt and dramatically increase the return on equity. Both Wightlink and Red Funnel were sought after assets and both were pursued at sale by three serious bidders, each of which had a broadly similar valuation of the target firm.
- 6.108 In the light of the tightening in credit markets, the recession, and the impact on demand for ferry services, the concern that the acquisition prices were too high appears justified. We consider the potential implications for consumers below.

## Debt levels

- 6.109 The second aspect of the concern put to us was that debt levels were too high and that the cash demands of servicing the debt put financial

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<sup>105</sup> [www.telegraph.co.uk/finance/2917633/Ferry-chiefs-ship-comes-in-with-Wightlink-sale.html](http://www.telegraph.co.uk/finance/2917633/Ferry-chiefs-ship-comes-in-with-Wightlink-sale.html) and <http://www.telegraph.co.uk/finance/markets/2810094/Prudential-buys-Isle-of-Wight-ferry-firm.html>

<sup>106</sup> Income before interest and taxes and depreciation and amortisation have been subtracted.

pressure on the companies. The reduction in the equity 'cushion' might mean that any shortfall in earnings could not so easily be absorbed by the owners, and that there may be implications for customers in terms of price rises or reductions in the quality of service.

- 6.110 When we raised this issue, both firms and their owners drew the distinction between external debt (debt that is held by firms outside the control of the group of parent companies and has associated covenants on particular assets) and shareholder loans (loans from the parent companies). External debt places a genuine cash demand on the business, whereas servicing and repayment of a shareholder loan is discretionary. In this respect, a shareholder loan functions more like an additional tranche of equity than like external debt.
- 6.111 In assessing indebtedness, therefore, we have looked primarily at the level of external debt. Wightlink has informed us that it has currently approximately £ [...] million of external debt. Red Funnel has advised us that it has currently approximately £ [...] million of external debt.
- 6.112 The question for our investigation is, if this level of debt should prove unsustainable in the current economic climate, would the consequences be shared between owners and lenders, or would customers also suffer in respect of higher prices or reduced quality of service? We turn to this question below.

#### Evidence of price increases since acquisition

- 6.113 Wightlink was last acquired in June 2005, half-way through the 2005 accounting year. In the three years since then, Wightlink's average yields on cars have increased by slightly less than RPI while foot yields have increased by more. So there is some evidence of an increase in prices under the current management. However, three years is a very short time period for comparisons when average yields can be unstable and unpredictable (depending, for example, on the take-up of low priced offers). Furthermore, this three year period has included steep increases in fuel prices. We do not, therefore, place a great deal of weight on price changes observed since 2005. Red Funnel was last acquired in 2007,

which allows even less time to assess price changes under the current owners.

### Evidence of intention or ability to increase prices

- 6.114 We also examined the companies' business plans. Both Wightlink and Red Funnel have shown us forward looking plans with projected price and average yield increases [...].
- 6.115 In Red Funnel's case, the business plan indicates that they are constrained in their ability to increase yields by competitive conditions. Given Red Funnel's position as the 'challenger' in this market (see Chapter 4) we find this plausible.
- 6.116 In Wightlink's case, however, evidence from a document associated with the acquisition indicates that Wightlink's ability to increase yields is constrained at least in part by the threat of competition law intervention. This suggests that competitive conditions alone do not fully constrain Wightlink's ability to raise prices in the future.

### Conclusion on ownership and financing arrangements

- 6.117 On balance, we find that the concerns expressed around the high acquisition prices today appear to have merit, although it is too early to say with any real certainty what the consequences will be.<sup>107</sup> The levels of external debt are also fairly high but again it is too early to tell what repercussions there will be, if any. In terms of the scope for knock-on effects on consumers, we believe this is a more serious risk in Wightlink's case than in Red Funnel's.

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<sup>107</sup> For the potential problems for infrastructure investments generally see [www.ftadviser.com/FinancialAdviser/AssetClass/Features/article/20080313/0e2288a6-eea0-11dc-8c04-0015171400aa/Building-on-strong-foundations.jsp](http://www.ftadviser.com/FinancialAdviser/AssetClass/Features/article/20080313/0e2288a6-eea0-11dc-8c04-0015171400aa/Building-on-strong-foundations.jsp)

## **7 PROPOSED DECISION ON MARKET INVESTIGATION REFERENCE**

- 7.1 This Chapter presents the OFT's proposed decision on a reference and sets this out in the context of the statutory reference test and the exercise of the OFT's discretion.
- 7.2 It also discusses voluntary action which we encourage the ferry operators to take in the light of the findings set out in this report, to make certain aspects of their performance more transparent to passengers and other stakeholders.

### **The section 131 reference test**

- 7.3 In order to make a market investigation reference, the OFT must have reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, 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 (the section 131 test). Where this threshold is met, the OFT has discretion as to whether to make a reference.
- 7.4 For the purposes of the section 131 test, the relevant market features can be either structural in nature or can relate to the conduct of suppliers, acquirers, or their customers. In practice there may not be a clear divide between structural features and those relating to conduct.
- 7.5 In the course of our analysis, we have engaged extensively with stakeholders and analysed a wide range of evidence. Following consideration of this evidence in the round, the OFT is minded to decide that there are reasonable grounds for suspecting that there are two features, in particular, which prevent, restrict or distort competition in the market for cross Solent ferry services:
- physical barriers to entry in the form of limited port facilities on the island

- the fact that routes may not be sufficiently busy to support more than one operator.

## Barriers to entry

- 7.6 The study has not found evidence to suggest that difficulty in obtaining access to port facilities is currently deterring new entry on cross Solent routes. However, in the light of the balance of evidence before the OFT (described in Chapter 5), its provisional view is that it would be difficult for a new entrant operator of a roll-on roll-off ferry service to share existing port facilities on the Isle of Wight with an existing ferry operator, or to establish new roll-on roll-off port facilities on the Isle of Wight, in the short to medium term.
- 7.7 Barriers to entry may be lower in relation to passenger ferry services, which require less physical infrastructure in terms of berthing or marshalling facilities.

## Sustainability of competition

- 7.8 As explained in Chapter 5, on-route competition is unusual in ferry markets, with only the busiest routes (such as cross Channel) typically able to sustain competition between several operators.
- 7.9 Our view is that, given the low levels of capacity utilisation on most routes at most times, there may be insufficient demand to sustain competition between two or more operators on most routes.

## Exercise of the OFT's discretion

- 7.10 The OFT has a discretion, rather than a duty, to make a reference where the section 131 test for making a reference is met. The OFT's guidance

on market investigation references sets out four criteria, all of which must, in its view, be met before the OFT decides to make a reference:<sup>108</sup>

- appropriateness of a reference: the scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it
- availability of remedies: there is a reasonable chance that appropriate remedies will be available
- undertakings in lieu: it would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference
- alternative powers: it would not be more suitable to deal with the competition issues identified by applying the Competition Act 1998 or using other powers available to the OFT.

7.11 Taking account of the relevant factors outlined in OFT's guidance for assessing whether these criteria are met,<sup>109</sup> the OFT is minded to decide that, although the reference test is met, the balance of the evidence reviewed in the round and the resulting assessment points in favour of exercising the OFT's discretion not to refer the Isle of Wight ferry services to the Competition Commission at the present time. The OFT's assessment against the four criteria is presented below.

### Appropriateness of a reference

7.12 In terms of the assessment of whether a reference is an appropriate response to the scale of the suspected problem, the OFT guidance provides that the OFT will only make a reference when it has reasonable grounds to suspect that the adverse effects on competition of the

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<sup>108</sup> OFT 511, 'Market investigation references: guidance about the making of references under Part 4 of the Enterprise Act', paragraph 2.1.

<sup>109</sup> OFT 511, Market investigation references, paragraphs 2.1 to 2.32.

relevant features of a market identified are significant. In this connection, it will consider whether the suspected adverse effects are likely to have a significant detrimental effect on customers through higher prices, lower quality, less choice or less innovation.<sup>110</sup> The OFT sets out below, in turn, its provisional conclusions on each of these issues.

## Prices

- 7.13 The OFT's provisional conclusion is that average prices on the vehicle ferries have risen broadly in line with inflation, whilst average prices for foot passengers have risen a little more sharply. There is no clear evidence in support of the allegation that the crossing is the most expensive in Europe.
- 7.14 The perception that prices have risen may be engendered by the ferry operators' switch to yield management pricing systems, which benefit those willing to be flexible and book in advance. Prices will have increased for those who are not flexible as to when they travel and who wish to just turn up and go. While islanders may be disproportionately in the latter category, this is not of itself indicative of competition problems. Furthermore, the OFT notes that islanders still receive certain discounts from the operators which may counter this disadvantage somewhat.
- 7.15 In response to the allegation that fares have risen above costs and that profits are excessive, the OFT first notes that prices do not appear to have risen faster than the relevant indices. Second, the OFT notes that, while profits may have been substantial in the past, they are lower in the current economic climate and it is not clear to the OFT that they are excessive at the present time.
- 7.16 In relation to the separate allegation that fares are bound to rise due to the high acquisition prices paid for Wightlink and Red Funnel and the

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<sup>110</sup> Ibid. at paragraph 2.27.

high levels of debt that the companies now bear, the OFT considers that it is too early to make a considered judgement as to whether these factors will lead to price rises.

## Quality

- 7.17 Overall, the OFT considers that the service is fairly comprehensive, particularly given that capacity utilisation can be very low at off-peak times. It is likely that some off-peak services (for example winter or night time sailings) would not be commercially viable on a standalone basis, and in this sense the level of service provided year round benefits from an element of cross-subsidy from the summer tourist trade.
- 7.18 While there has been some decline in frequency and punctuality in recent years, this does not appear to be part of a long-term trend. The OFT notes that the operators have made significant investment in their fleet in recent years. However, the complaints the OFT has seen suggest that the ferry operators do have some way to go to improve customer satisfaction.

## Choice

- 7.19 There has been some reduction in the number of routes being operated since the 1991 MMC report. Cowes Express has left the market (it used to run between Southampton and West Cowes) and Red Funnel has ceased operating vehicle ferries between Cowes and Portsmouth. Nonetheless, there are six ways a foot passenger can get on and off the island, and three ways to arrive on or leave the island by car. No-one has expressed to us any concern about lack of choice in this respect.

## Innovation

- 7.20 Innovation in this market appears somewhat slow. While there have been recent investments in new craft, new booking systems and improvements such as Wi-Fi connectivity on some sailings, the OFT's perception is that these developments were not before time.

Nonetheless, it is hard to pinpoint any clear detriment in respect of lack of innovation.

## Significance of adverse effects

7.21 The Guidance sets out three factors that are taken into account in assessing the significance of any adverse effects on competition or customer detriment arising from them:

- the size of the market
- the proportion of the market affected by the feature or features giving rise to adverse effects on competition
- the persistence of the feature or features giving rise to adverse effects on competition.

7.22 In relation to the first factor, the OFT notes that the market for Isle of Wight ferry services is relatively small being worth only some £90m annually. However, the Guidance states that problems in some relatively small specialised or local markets can have a significant detrimental impact on customers affected by them, in which case an MIR may be justified.<sup>111</sup> The OFT recognises that the ferry services are vital to the Isle of Wight, so in this case the size of the market would not in itself prevent the making of an MIR.

7.23 In relation to the second factor, the OFT notes that the entire market is affected by the features identified. In relation to the third factor, the OFT considers that the features identified are unlikely to change in the short to medium term.

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<sup>111</sup> Ibid. at paragraph 2.28

## Provisional conclusion on appropriateness of a reference

- 7.24 In conclusion, the OFT acknowledges that the size of the market, proportion affected and persistence of the features would not prevent the making of an MIR. However, the OFT has found limited evidence of clear consumer detriment in terms of price, quality, choice or innovation. For this reason, on balance, the OFT does not consider that it would be appropriate to make a reference.

## Offsetting customer benefits

- 7.25 The Guidance<sup>112</sup> notes that in some cases market features which adversely impact on competition may also produce offsetting customer benefits. The OFT has not taken this into account in its provisional decision not to make an MIR. However, the OFT observes that it may be the case that islanders presently receive a more comprehensive service than would be the case if the ferry operators concentrated on the most profitable sailings and reduced or ceased operating the less well utilised and commercially viable sailings, as might be the case in a fully competitive market.
- 7.26 The OFT also notes, in this regard, that there is a direct element of cross- subsidy insofar as islanders are entitled to special discounts which are not available to non-residents. Again, in a fully competitive market such cross-subsidisation would not be feasible.

## Availability of remedies

- 7.27 In principle, the OFT could envisage remedies of two broad types to the problem of limited competition.
- 7.28 First, there are measures directed at introducing more competition into the market. This could involve:

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<sup>112</sup> Ibid. at paragraph 2.29

- requiring the ferry companies to open access to their port facilities. However, as discussed in Chapter 5, we believe there are genuine logistical difficulties which make this impracticable
- requiring the ferry companies to enter into some form of route-sharing arrangement. However, it is not clear that this would be either logistically feasible or economically efficient. Furthermore, it would almost certainly require significant and burdensome regulatory oversight
- forcing the sale of one or more routes. However, as discussed in Chapter 4, the OFT does not believe that if the Yarmouth-Lymington route were operated by a different company, the increase in inter-route competition would be significant
- devising some form of competition 'for the market'. The OFT believes that this is the most realistic prospect for increasing competition in the provision of cross Solent ferry services. However, given the investment made by the ferry companies in specific and long-lived assets, this type of remedy is potentially extremely intrusive and the OFT does not believe it would be justified in response to the level of detriment observed.

7.29 Second, there are regulatory solutions – some form of price and/or quality control. However, since the OFT does not believe that prices or quality of service indicators (with the possible exception of customer satisfaction) are far out of line with where they should be, this type of remedy would not be proportionate or appropriate in this case. We note also the risk that this kind of intervention could have an adverse impact on future levels of investment by the ferry operators.

### Alternative powers

7.30 In view of the above, it is not necessary to go on to consider, as an additional rationale for not exercising the OFT's discretion to make an MIR, the appropriateness of dealing with the competition issues arising from the features identified pursuant to section 131 of EA02 by applying

the Competition Act 1998. It is noted, nonetheless, that we found no evidence of anti-competitive agreements between the parties. In particular, we found no evidence of the ferry operators colluding on fare levels, and some evidence to indicate that this is not happening.

### Undertakings in lieu

- 7.31 Under section 154(1) of the EA02, the OFT has the power to accept undertakings in lieu of a reference if it considers that it has the power to make a reference under section 131 and otherwise intends to do so. Since, in this instance, the OFT is minded to decide not to make a reference, for the reasons set out above, it does not have the power to accept undertakings in lieu.

### Provisional decision not to make a reference

- 7.32 In conclusion, the OFT is minded to decide that, although the reference test is met, the balance of the evidence when reviewed in the round and the resulting assessment points in favour of exercising the OFT's discretion not to refer the Isle of Wight ferry services to the Competition Commission at the present time.
- 7.33 The OFT's provisional view is that there are reasonable grounds for suspecting that barriers to entry and the fact that routes can only support one operator are features which prevent, restrict or distort competition. However, there appears to be limited evidence of consumer detriment, and the OFT does not believe that there is an available remedy which is appropriate or proportionate to the detriment identified.

### Other outcomes from a market study

- 7.34 Nonetheless, the OFT does not believe that competition is strong in this market. We have seen evidence to suggest that Wightlink's prices have to date been constrained by the threat of competition investigation, rather than purely by market forces. So it is important to stress that the fact that the OFT is minded to decide not to make an MIR on this occasion does not constrain it from further examination of the market in

future if presented with cogent evidence that such further examination is warranted.

7.35 Furthermore, the OFT's analysis in response to the concerns expressed over the acquisition prices and debt levels of Wightlink and Red Funnel is inconclusive as to whether the financial pressures which undoubtedly face the operators in the current climate may have knock-on effects for consumers.

7.36 For these reasons, we believe it is important to consider the various outcomes, other than making an MIR, which the OFT may propose following a market study. These include:

- giving the market a clean bill of health
- publishing information to help consumers
- encouraging firms to take voluntary action
- encouraging an industry code of practice
- making recommendations to the Government or sector regulators
- investigation and enforcement action against companies suspected of breaching consumer or competition law.

7.37 It appears to us that the ferry companies and the Isle of Wight residents alike would benefit from better information about price rises and quality of service. This would allow the operators to demonstrate to the island residents that they care about monitoring and improving services and allow consumers to make an objective assessment of the services they receive.

7.38 This would involve voluntary action by the ferry operators to increase transparency about their performance over time. This might involve, for example, a commitment on the part of the operators to publish in consistent and comparable format, independently verified information on price trends, frequency and reliability, and customer satisfaction.

7.39 Both Wightlink and Red Funnel have already indicated that they see some merit in taking steps to improve transparency, and indeed that they already publish or have plans to publish some key quality of service indicators. We look forward to discussing their concrete proposals in this regard.

## 8 NEXT STEPS AND CONSULTATION QUESTIONS

8.1 Under section 169 of the EA02, where the OFT is proposing to make an MIR it must first consult so far as is practicable any person on whose interests the reference is likely to have a substantial impact. Although, in this case, the OFT is minded to decide not to make an MIR, it invites views from interested parties given, among other matters, the high level of public interest and engagement in this case among island residents. The OFT therefore invites views from interested parties on:

- the evidence the OFT has gathered, about the nature and scale of the problems identified
- the provisional decision not to refer the Isle of Wight ferry services to the Competition Commission
- the proposal to seek further transparency commitments from the ferry companies to facilitate monitoring of their performance.

8.2 Please send submissions by 5 pm on 12 August 2009 to:

Jay Thakar

Infrastructure and the Knowledge Economy

Floor 2C

Office of Fair Trading

Fleetbank House

2-6 Salisbury Square

London EC4Y 8JX

Email: [isleofwightferries@oft.gov.uk](mailto:isleofwightferries@oft.gov.uk)