Terms of reference and conduct of the inquiry

Terms of reference

1. On 13 May 2009 the OFT sent the following reference to the CC:

   1. In exercise of its duty under section 22(1) of the Enterprise Act 2002 ("the Act") to make a reference to the Competition Commission ("the CC") in relation to a completed merger the Office of Fair Trading ("the OFT") believes that it is or may be the case that—

      (a) relevant merger situations have been created in that:

         (i) enterprises carried on by or under the control of **Stagecoach Group Plc** have ceased to be distinct from enterprises carried on by or under the control of **Eastbourne Buses Limited**;

         (ii) enterprises carried on by or under the control of **Stagecoach Group Plc** have ceased to be distinct from enterprises carried on by or under the control of **Cavendish Motor Services Limited**; and

         (iii) as a result of each of (a)(i) and (a)(ii) above, the condition specified in section 23(4) of the Act will prevail, or will prevail to a greater extent, with respect to the supply of commercial bus services in Eastbourne, East Sussex; and

      (b) the creation of each of these situations has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services, including the supply of commercial local bus services in Eastbourne, East Sussex.

   2. Therefore, in exercise of its duty under section 22(1) of the Act, the OFT hereby refers to the CC, for investigation and report within a period ending on 27 October 2009, on the following questions in accordance with section 35(1) of the Act, in relation to each of the situations described in (a)(i) and (a)(ii), above—

      (a) whether a relevant merger situation has been created; and

      (b) if so, whether the creation of that situation has resulted or may be expected to result in a substantial lessening of competition within any market or markets in the UK for goods or services.

   3. For each of the situations described in (a)(i) and (a)(ii), above, in relation to the question whether a relevant merger situation will be created, the CC shall exclude from consideration one of the subsections (1) and (2) of section 23 of the Act if they find that the other is satisfied.

   (signed) **Amelia Fletcher**
   Senior Director, Mergers, Office of Fair Trading
   13 May 2009

Conduct of the inquiry

2. A notice inviting written views on the inquiry was posted on the CC website on 14 May 2009 and an advertisement inviting written evidence was also placed in the *Eastbourne Herald* on 22 May 2009. The administrative timetable for the inquiry was published on the CC website on 27 May 2009.

3. We invited a number of interested third parties (including potential competitors, customers, consumer groups and other bodies) to comment on the proposed merger and sent detailed questionnaires to potential competitors. Evidence was also obtained through oral hearings with third parties, through telephone contacts and further written requests. Non-confidential versions of the evidence provided to us by third parties in response to our invitation to comment and summaries of our oral hearings can be found on the CC website.

4. On 1 June 2009, members of the Group, accompanied by staff, visited EBL's office and bus depot located in Eastbourne and heard presentations from Stagecoach and EBC. On this visit, members and staff also viewed the Cavendish fleet and the rented parking area out of which Cavendish had operated its buses.

5. A statement of issues was published on the CC website on 12 June 2009.

6. We received written evidence from Stagecoach and held a hearing with it on 2 July 2009. A non-sensitive version of its main submission can be found on our website. Following the hearing, Stagecoach also provided the CC with a restatement of case submission, which restated certain key arguments.

7. Our provisional findings report and the Notice of Possible Remedies were published on the CC website on 6 August 2009. We then held remedies hearings with Stagecoach and a number of third parties. Non-confidential responses to the provisional findings report and the Notice of Possible Remedies from Stagecoach and third parties were placed on our website.

8. In the course of this inquiry, we have sent Stagecoach extracts from a number of working papers and received comments from it which have been taken into consideration.

9. We also took steps to prevent any further integration between Stagecoach, EBL and Cavendish:

- On 18 May 2009, we adopted the initial undertakings given by Stagecoach to the OFT on 18 February 2009, while considering whether any further action was necessary to prevent pre-emptive action by the parties, which might prejudice the reference or impede the taking of any action by the CC under Part 3 of the Act which might be justified by the CC's decisions on the reference.

- On 22 May 2009 we issued Directions under the adopted undertakings requiring Stagecoach to appoint a Monitoring Trustee (appointed 1 June 2009) to ascertain the level of integration which had occurred and the current level of compliance with the undertakings; to assess the current and proposed arrangements for managing the Stagecoach, EBL and Cavendish businesses, including any changes to those arrangements which may be necessary; to supervise the establishment of mechanisms for ensuring compliance with the undertakings; and to monitor compliance by Stagecoach.

- Following the Monitoring Trustee's first report to us regarding the level of integration, and current and proposed management arrangements, we issued further directions to Stagecoach on 26 June 2009 requiring changes to the management structure of EBL and a more active role for the Monitoring Trustee in monitoring communications between EBL and Stagecoach.

10. We would like to thank all those who assisted in our inquiry.

11. The text of this final report has been placed on the CC website.

Financial performance of Eastbourne Buses Limited

Introduction

1. Prior to its acquisition by Stagecoach, EBL provided bus services in the Eastbourne area (plus some inter-urban routes), operating out of a bus parking and maintenance depot with capacity for 100 buses based in Birch Road, Eastbourne. At the time of its acquisition by Stagecoach, EBL employed 152 employees and operated a fleet of 50 vehicles. For the financial year ended 31 December 2008, EBL generated total revenues of £5.5 million and an operating loss of £[✂] million.

2. In 2008, revenues from local bus services accounted for just over 90 per cent of EBL's revenues, the rest being accounted for by ancillary services, including operating a tourist coach park on land adjoining its depot; the Dotto tourist train service on behalf of EBC along Eastbourne's seafront promenade; and providing engineering services (eg MOT sales) (see Table 2 for a breakdown of EBL's revenues).

3. EBL was 80 per cent owned by EBC and 20 per cent by Keolis (since June 2001). As majority shareholder, EBC was able to nominate four non-executive directors, one of whom could also be appointed Board Chairman. However, given the legal restrictions[1] concerning EBC's ability to actively manage EBL, EBC operated the company on an arm's-length basis and had little active involvement in EBL's operations, instructing its non-executive directors on the EBL board not to interfere in EBL's commercial decisions. Keolis, as 20 per cent minority shareholder, also told us that it managed the company on an arm's-length basis and did not involve itself in EBL's day-to-day operations and management decisions.

4. The profit and loss account figures presented in EBL's management and statutory accounts do not fully reconcile, which we understand was due to a number of year-end and prior-year audit adjustments to EBL's management account figures.[2] Given that the management accounts provide greater detail of EBL's profit and loss account, including its 2008 figures which are only available in management account form, we have presented the historic profit and loss figures from both EBL's management and statutory accounts.

EBL's historic financial performance

5. Table 1 shows the profit and loss account for EBL as set out in its statutory accounts for the financial years ended 31 December 2004 to 2007.

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[1]The Transport Act 1985 resulted in local authorities being obliged to transfer their bus operations to entities operating at arm's length.
[2]Examples of EBL's prior-year audit adjustment include: a prior-year provision for pension costs in 2004 in the 2005 statutory accounts; EBL recognizing both the revenues and costs from internally performed maintenance work in 2006 which were subsequently netted off as a prior year adjustment in the 2007 statutory accounts; and 2006 vehicle hire costs being reallocated from overheads into direct costs in the 2007 statutory accounts.

TABLE 1 **EBL: profit and loss (statutory accounts), financial years ended 31 December 2004 to 2007**

				£'000
	2004	*2005*	*2006*	*2007*
Revenues	N/A	N/A	6,480	6,111
Gross profit	1,637	1,970	1,038	890
Margin (%)	*N/A*	*N/A*	*16%*	*15%*
EBITDA*	401	448	29	159
Margin (%)	*N/A*	*N/A*	*0%*	*3%*
Depreciation & amortization	–474	–540	–435	–332
Operating loss	–72	–92	–406	–172
One-off pension provision adjustment†	–1,474	-	-	-
Operating loss (post pension prov)	–1,546	–92	–406	–172
Exceptional items/profit on disposals	–7	6	60	–144
Operating loss (post exceptionals)	–1,554	–86	–346	–316
Net interest	–162	–148	–127	–32
Profit before tax	–1,716	–234	–473	–348
Tax	327	42	54	15
Net income	–1,389	–192	–420	–334

Source: EBL statutory accounts (2005 to 2007).

*Earnings before interest, tax, depreciation and amortization.
†In 2004, there was an exceptional charge of about £1.5 million for a provision in relation to service costs for EBL's defined benefit pension scheme, through a prior-year audit adjustment in its 2005 statutory accounts. EBL's pension liabilities had not been recognized on its balance sheet prior to 2004 since EBL had not obtained actuarial valuations of its pension schemes in respect of earlier years. Whilst EBL's auditors had charged the provision in full against EBL's 2004 gross profit figure, which was restated from £1.7 million (based on its 2004 statutory accounts) down to £0.2 million (based on its 2005 statutory accounts), we have moved the provision below the operating loss line to provide a more like-for-like comparison of 2004's figures with the other periods.
Notes:
1. Where the statutory accounts restate prior year figures, the restated figures have been presented in this table.
2. N/A = not available.

6. In 2005, EBL's gross profit increased by 20 per cent from £1.6 million in the prior year to £2.0 million, with EBITDA increasing by 12 per cent from £401,317 to £448,359 (see Table 1). After deducting for depreciation and amortization, EBL made an operating loss of £72,190 in 2004 and £91,996 in 2005. However, 2004's results were adversely impacted by an exceptional charge of about £1.5 million, in relation to a provision for pension service costs, which increased EBL's 2004 operating loss from £72,190 to £1.5 million.

7. In 2006, EBL's gross profit and EBITDA fell sharply to £1.0 million and £29,118 respectively, against a backdrop of Cavendish's entry into the Eastbourne market in March 2006 (see also EBL's management accounts presented in Table 4).

8. Whilst EBL's gross profit declined by 14 per cent to £0.9 million in 2007, EBITDA increased to £159,192, as a result of overheads as a percentage of revenues falling from 16 to 12 per cent.

9. Table 2 shows the profit and loss account for EBL based on its management accounts for the financial years ended 31 December 2006 to 2008. As mentioned above, due to year-end and prior-year audit adjustments, the company's figures in the management accounts do not fully reconcile with its statutory accounts.

TABLE 2 **EBL: profit and loss (management accounts*), financial years ended 31 December 2006 to 2008**

			£'000
	2006	*2007*	*2008*
Revenues			
On-bus commercial/tender	[✂]	[✂]	[✂]
Off-bus sales	[✂]	[✂]	[✂]
Concessionary	[✂]	[✂]	[✂]
Scholars	[✂]	[✂]	[✂]
Tender	[✂]	[✂]	[✂]
Total local bus	[✂]	[✂]	[✂]
Contracts	[✂]	[✂]	[✂]
Private hire	[✂]	[✂]	[✂]
Dotto	[✂]	[✂]	[✂]
Engineering revenue	[✂]	[✂]	[✂]
Fuel net	[✂]	[✂]	[✂]
Miscellaneous	[✂]	[✂]	[✂]
Total other revenues	[✂]	[✂]	[✂]
Total revenues	[✂]	[✂]	[✂]
Costs			
Drivers costs	[✂]	[✂]	[✂]
Fuel	[✂]	[✂]	[✂]
Bus service operators grant	[✂]	[✂]	[✂]
PSV insurance	[✂]	[✂]	[✂]
Other direct costs	[✂]	[✂]	[✂]
Engineering costs	[✂]	[✂]	[✂]
Operational costs	[✂]	[✂]	[✂]
Depot overheads	[✂]	[✂]	[✂]
Head office overheads	[✂]	[✂]	[✂]
Total costs	[✂]	[✂]	[✂]
EBITDA	[✂]	[✂]	[✂]
Margin (%)	[✂]	[✂]	[✂]
Depreciation	[✂]	[✂]	[✂]
Operating loss	[✂]	[✂]	[✂]
Total passengers ('000)	[✂]	[✂]	[✂]
Total mileage ('000)	[✂]	[✂]	[✂]

Source: EBL management accounts.

*Due to a number of year-end and prior-year audit adjustments to EBL's management account figures, the profit and loss account figures presented in EBL's management and statutory accounts do not fully reconcile.

10. Based on EBL's management accounts, total revenues declined from £[✂] million in 2006 to £5.5 million in 2008, driven largely by a reduction in on-bus revenues, which fell from £[✂] million in 2006 to £[✂] million in 2008. Whilst reimbursement for concessionary travel increased by £[✂] million from £[✂] million in 2006 to £[✂] million in 2008, this was insufficient to offset the significant reductions in on-bus revenues and tender revenues, which decreased by £[✂] million and £[✂] million respectively between 2006 and 2008. A former interim Managing Director for EBL stated that the new concession reimbursement arrangements were 'inadequate resulting in a large reduction of revenue … a serious situation in Eastbourne because of the large proportion of elderly people'. Revenues from ancillary services, including MOT servicing sales and Dotto tourist train services, decreased by £[✂] from £[✂] in 2006 to £[✂] in 2008.

11. On-bus revenues accounted for just over [✂] per cent of total revenues over the period, the largest component of EBL's total revenues. This was followed by concessionary fare revenues, which accounted for between [✂] and [✂] per cent of total revenues between 2006 and 2008.

12. Against EBL's total revenues decreasing by [✂] per cent over the period from 2006 to 2008, EBL's total mileage fell from 2.5 million to 1.9 million, a decrease of 24 per

cent; and total passengers fell from 4.5 million to 4.4 million, a decrease of 2 per cent.

13. Whilst EBL's total costs (including both direct costs and overheads) declined in absolute terms from £[✂] million in 2006 to £[✂] million in 2008, total costs as a percentage of total revenues increased from [✂] per cent in 2006 to [✂] per cent in 2008, particularly given the fixed nature of bus depot/head office costs, resulting in EBL's EBITDA to decrease from a profit of £[✂] in 2006 to a loss of £[✂] in 2008. EBL generated an operating loss of £[✂] in 2008 and a cumulative operating loss of around £[✂] between 2006 and 2008.

14. Keolis told us that prior to EBL's acquisition by Stagecoach, it did not believe that EBL could 'continue its operations beyond the short term', given that: *(a)* EBL was 'unable to benefit from economies of scale available to larger operators' due to the size of the market; *(b)* EBL had a 'structurally high cost base'; and *(c)* 'the arrival of the competition brought by Cavendish' had adversely impacted EBL's revenues. Keolis also stated that EBL had been 'loss-making for several years and … had no option other than to finance these losses by progressively selling or mortgaging its assets'.

15. A number of factors appear to have contributed to EBL's deteriorating financial performance; these were: *(a)* poor management decisions, eg the withdrawal of circular route services in 2001; *(b)* high staff cost issues, including its defined benefit pension scheme, a legacy scheme which had transferred to EBL on incorporation in 1986, which still had a number of active members; and *(c)* competition from Cavendish, to which EBL management did not appear to have responded effectively.

16. Table 3 shows EBL's historic cash flow performance for the financial years ended 31 December 2004 to 2007.

TABLE 3 **EBL: cash flow statement (statutory accounts), financial years ended 31 December 2004 to 2007**

£'000

	2004	*2005*	*2006*	*2007*
Operating loss (post exceptionals)	–1,554	–86	–346	–316
Depreciation & amortization	474	540	435	332
Non-cash item adjustments	7	–6	–60	–208
Net working capital movements	106	–63	217	52
Provisions (incl pension prov)	1,474	91	138	154
Pension contributions	-	–83	–90	–123
Capex	–217	–74	–15	–25
Tax	346	2	-	-
Cash flows from operations	636	322	279	–135
Disposal proceeds	106	67	585	176
Increase in bank loans	-	-	-	272
Cash flows available for debt service	742	388	864	313
Financing costs				
Net debt interest (excl leasing)	–25	–20	–19	–16
Leasing interest	–138	–128	–150	–60
EBC debenture repayments	–25	–50	–50	-
Leasing capital repayments	–410	–489	–691	–276
Other	–6	–15	-	-
	–603	–703	–910	–352
Net cash flows	138	–314	–46	–39

Source: EBL statutory accounts (2005 to 2007).

17. Table 3 shows that EBL had not generated positive net cash flows since 2004, given its operating losses; payments made towards its defined benefit pension scheme; and relatively significant debt service costs, in particular in relation to interest and capital repayments on its finance leases, which were £840,778 in 2006 and £335,523 in 2007.

18. During the period from 2004 to 2007, EBL supplemented its cash flows from operations through several asset disposals, which amounted to around £1 million. In April 2007, one of EBL's executive directors provided EBL with a personal loan of £150,000 to resolve EBL's short-term cash flow issues. This loan was repaid when EBL raised new bank loans in October 2007 following EBC's decision to release to the bank some of its security under its debenture loan. After taking into account additional cash from asset disposals and new debt financing, EBL did not generate any surplus cash, with negative cash flows of £45,852 and £39,300 in 2006 and 2007 respectively. Based on EBL's balance sheet (see Table 4), EBL's cash balances reduced from £250,911 as at 31 December 2004 to £1,573 in 2005, with EBL utilizing its overdraft facility thereafter. EBC told us that EBL's overdraft utilization was sustained at around £400,000, close to its facility limit of £500,000. The overdraft facility was due for renewal with the bank on 31 December 2009.

19. In April 2008, EBL management informed EBC that: *(a)* the company's 'trading position was now not tenable'; *(b)* EBL's auditors had qualified its audit opinion on its 2007 accounts; and *(c)* 'the level of the overdraft was critical and the bank would not extend its exposure without some form of security for both the existing overdraft and any extension [of the facility limit]'. In response and in order to ease the pressure on EBL's cash flows, EBC took the decision not to pursue payments of around £140,000 from EBL in relation to its Dotto tourist train licence payments; interest payments on its debenture loan; and rental payments in relation to EBL's tourist coach park. These outstanding payments were recovered by EBC in full following completion of the sale in December 2008.

20. In May 2008, EBC told us that it was advised that it had grounds to put EBL into administration. Instead EBC pursued a sale process to fully dispose of both shareholders' stakes in EBL 'in order to get the best sale arrangement and to maintain continuity of bus services to the public'.

21. Table 4 shows EBL's historic balance sheets as at 31 December 2004 to 2007.

TABLE 4 **EBL: balance sheet (statutory accounts) as at 31 December 2004 to 2007**

				£'000
	2004	*2005*	*2006*	*2007*
Fixed assets				
Tangible assets	4,088	3,646	2,578	2,584
Intangible assets	219	187	154	122
Investments	0	0	0	0
	4,308	3,833	2,732	2,706
Current assets				
Stock	161	184	176	166
Debtors	426	602	416	392
Cash	251	2	0	0
	838	787	592	559
Current liabilities				
Trade creditors	–469	–624	–405	–334
Bank loans/overdraft	-	–63	–107	–240
Finance leases	–449	–490	–295	–233
Other creditors/accruals	–187	–169	–407	–501
	–1,105	–1,345	–1,214	–1,308
Net current assets/liabilities	–267	–558	–622	–749
Total assets less current liabilities	4,041	3,275	2,110	1,957
Long-term liabilities				
EBC debenture loan	–300	–250	–200	–200
Bank loans/overdraft	-	-	-	–179
Finance leases	–1,735	–1,259	–607	–490
Other creditors	–45	–30	–30	–30
Provisions (excl pensions)	–97	–56	–40	–100
	–2,178	–1,596	–877	–1,000
Pension liabilities (net deferred tax)	–1,474	–1,482	–929	–895
Net assets (excl pension liabilities)	1,863	1,679	1,232	958
Net assets (incl pension liabilities)	389	197	303	63
Shareholders' funds				
Called-up share capital	1,910	1,910	1,910	1,910
Share premium account	80	80	80	80
Revaluation reserve	-	-	-	150
Retained profit	–1,601	–1,793	–1,687	–2,077
	389	197	303	63
Current assets/current liabilities (times)	0.8	0.6	0.5	0.4

Source: EBL statutory accounts (2005 to 2007).

Note: Where the statutory accounts restate prior year figures, the restated figures have been presented in this table.

22. As at 31 December 2007, the net book value of EBL's tangible assets was £2.6 million, which mainly comprised £1.1 million for property and £1.4 million for its vehicle fleet. The material provision of £100,000 on its balance sheet in 2007 was a contingent liability that related to an ongoing prosecution made by the Health & Safety Executive against EBL, which has recently been settled and the fine paid.

23. As at 31 December 2007, EBL had total financial liabilities of £1.3 million, of which £0.5 million fell due within 12 months. A schedule of EBL's financial liabilities is presented in Table 5, which shows that finance leases accounted for just over half of its financial liabilities. Including EBL's net pension deficit into our debt calculation of around £0.9 million, EBL's total financial liabilities increase to £2.2 million.

TABLE 5 **EBL: financial liabilities as at 31 December 2007 (statutory accounts)**

	£'000
Current liabilities	
Bank overdraft	240
Finance leases	233
	473
Long-term liabilities	
EBC debenture loan	200
Bank loans/overdraft	179
Finance leases	490
	869
Total liabilities	1,343

Source: EBL 2007 statutory accounts.

Financial performance of Cavendish Motor Services Limited

Introduction

1. Cavendish provided local bus services in the Eastbourne area from 13 March 2006 when it entered the market with a fleet of three buses. Its fleet had increased to 28 buses by the time the business was acquired by Stagecoach on 5 January 2009. For the financial year ended 31 July 2008, Cavendish generated revenues of £0.6 million and operating profit of £[✂].[1]

2. Cavendish was a private company, which was established and wholly owned by Christian Harmer, the Managing Director for Renown, a bus operator based in Bexhill in East Sussex, around 12 miles from Eastbourne. Renown primarily operates bus contracts with ESCC, won through competitive tendering, together with commercial coach hire and day excursions.

3. Whilst Cavendish was established as a separate sister company from Renown, its owner had not operated Cavendish as a stand-alone business and Cavendish's operations effectively became an extension of Renown, including an element of revenue and cost sharing between the two companies. Renown told us that there was 'cross-subsidy between the network and between Renown and Cavendish as well' and that Cavendish did not have a separate invoicing system from Renown. Therefore, Cavendish's financials have been distorted by this level of interaction between Renown and Cavendish to the extent that: *(a)* Renown recognized some revenues derived from operating its own buses on Cavendish's routes within Eastbourne; and *(b)* not all costs relating to functions provided by Renown were allocated to Cavendish's profit and loss figures.

4. Cavendish operated its bus services out of a rented parking space in Polegate, 6 miles north of Eastbourne, which had no maintenance or refuelling facilities. Instead, Renown provided Cavendish with back-office functions (eg administration, IT, supply arrangements and maintenance) from its maintenance workshop in Bexhill. Therefore, given that these arrangements had been in place since Cavendish started trading in 2006, it is difficult accurately and reliably to assess Cavendish's financial performance as a stand-alone business. Whilst noting the issues surrounding the financial data within the management accounts for Cavendish and in the absence of any accurate cost data, we have based our high-level review of Cavendish's historic financial performance below using information from its management accounts. We present further analysis of Cavendish's profitability based on different data sources in Appendix H, paragraphs 30 to 48.

Cavendish's historic financial performance

5. Table 1 shows a timeline of Cavendish's operational fleet size since it entered the market in 2006.

[1] Based on Cavendish's management accounts.

TABLE 1 **Timeline of Cavendish's operations**

Date	*Cavendish fleet size*
13 March 2006	3 buses
10 July 2006	5 buses
15 January 2007	5 buses plus 1 off-peak
9 July 2007	7 buses plus 1 off-peak
4 February 2008	11 buses plus 1 off-peak
25 March 2008	12 buses plus 1 off-peak
14 July 2008	23 buses plus 2 off-peak
8 September 2008	26 buses plus 2 off-peak
1 December 2008	25 buses plus 2 off-peak

Source: Stagecoach.

6. Table 1 shows that Cavendish increased its fleet significantly in February/March 2008 and July/September 2008, with much of the fleet expansion aimed at increasing its peak services. However, it is unclear whether the figures above accurately reflect the size of Cavendish's fleet that was required to operate its timetabled routes, given that:

   (a) Renown told us that it operated some of Cavendish's routes using its own buses: some services were registered by Renown until 13 July 2008 and from 14 July 2008, all services were registered by Cavendish even though they may have been operated by Renown's buses on hire to Cavendish; and

   (b) during the due diligence process on Cavendish in September 2008, Stagecoach discovered that Cavendish had 28 vehicles but only 20 operator licences and so needed to use operator licences from Renown.

   Stagecoach also told us that Cavendish had only had one spare bus and so would have needed to use spare vehicles on occasion from Renown's fleet to cover breakdowns, servicing and MOTs. It is therefore likely that the above figures for Cavendish's fleet do not accurately reflect the number of buses operating on Cavendish's routes.

7. Renown told us that it increased its peak services following press reports and rumours that EBL was in 'serious financial difficulties' with the aim that it 'did not want to give another bus operator the chance to register services in Eastbourne' and to 'provide a real alternative to Eastbourne Buses in the event of their failure'. These increases in peak services during the second half of 2008 appear to have been based on a combination of Cavendish aiming to further weaken EBL, in the anticipation that it would lead to its failure; and in the event that EBL was sold to another operator, to ensure that Cavendish was considered as a strategic target for any company that acquired EBL. We assess the financial impact these changes in peak services had on Cavendish's financial performance during its financial year ending 31 July 2009 in paragraphs 13 to 15. However, as noted above, given that the financial analysis has been based on Cavendish's management accounts, we remain cautious over the conclusions from our financial analysis.

8. Table 2 shows Cavendish's historic profit and loss performance between 2007 and the period to 5 January 2009 (the completion date for its acquisition), based on its management accounts.

TABLE 2 **Cavendish profit and loss (management accounts), financial year ended 31 July 2007 to the period ended 5 January 2009**

			£'000
	2007 12 months	*2008 12 months*	*2009 1 Aug 08– 5 Jan 09*
Revenues			
Daily cash takings	[✂]	[✂]	[✂]
Concessionary fares	[✂]	[✂]	[✂]
Advertising income/contracts	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]
Direct costs			
Driver costs	[✂]	[✂]	[✂]
Fuel costs	[✂]	[✂]	[✂]
Fuel duty rebate	[✂]	[✂]	[✂]
Motor licences/registrations	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]
Gross profit	[✂]	[✂]	[✂]
Margin (%)	[✂]	[✂]	[✂]
Overheads			
Motor repairs/servicing	[✂]	[✂]	[✂]
Other motor expenses	[✂]	[✂]	[✂]
Printing & stationery	[✂]	[✂]	[✂]
Professional fees	[✂]	[✂]	[✂]
Maintenance	[✂]	[✂]	[✂]
Depreciation	[✂]	[✂]	[✂]
Miscellaneous expenses/wages	[✂]	[✂]	[✂]
	[✂]	[✂]	[✂]
O/H as % of revenues (%)	[✂]	[✂]	[✂]
Operating profit/loss	[✂]	[✂]	[✂]
Margin (%)	[✂]	[✂]	[✂]
Bank interest & charges	[✂]	[✂]	[✂]
Dividends	[✂]	[✂]	[✂]
Profit less interest & dividends	[✂]	[✂]	[✂]

Source: Cavendish management accounts.

9. Cavendish's financial years ended 31 July 2007 and 2008 effectively cover the first two years of its operations. Whilst the management accounts show that Cavendish generated total revenues of £0.6 million in 2008, Renown told us that Cavendish's reported revenue figure did not account for local bus revenues generated on Renown's buses operating on Cavendish's routes and understated the level of re-imbursement on concessionary fares. Renown stated that the revenue figure was therefore likely to be higher.

10. Based on the management accounts, Cavendish's revenues grew from £[✂] million in 2007 to £0.6 million in 2008, an increase of [✂] per cent. Growth was driven by an increase in both daily bus cash takings, which increased by around [✂] per cent from £[✂] to £[✂], and concessionary fares, which increased by around [✂] per cent from £[✂] to £[✂].

11. In 2007 and 2008, daily bus cash takings accounted for just over [✂] per cent of total revenues, with concessionary fare revenues accounting for [✂] per cent of total revenues in 2007 and [✂] per cent in 2008.

12. Direct costs, which included driver, fuel (net of fuel duty rebate) and licence costs, accounted for [✂] and [✂] per cent of total revenues in 2007 and 2008 respectively. Whilst we included tyre and insurance costs in our definition of Direct Costs for our analysis of Cavendish's longer-term profitability in paragraphs 30 to 48 of Appendix H, these cost items could not be separately identified from the management accounts

and we were not able to account for these items in our calculation of direct costs in Table 2. Driver costs accounted for the largest cost component of direct costs, accounting for [✂] per cent of total revenues in 2007 and [✂] per cent in 2008. Given that Renown provided much of Cavendish's support and central functions, it appeared that Renown operated Cavendish largely in relation to covering its direct costs, given that much of its overhead costs were already incurred in Renown's own operations. Therefore, there were minimal overhead costs in Cavendish's business model, with overhead costs accounting for [✂] and [✂] per cent of total revenues in 2007 and 2008 respectively. Cavendish was operated as a low-cost operation and did not incur the same level of costs incurred by EBL, eg pension and premises costs, and its results reflect these cost-sharing arrangements with its sister company Renown. Cavendish generated operating profit margins of [✂] and [✂] per cent in 2007 and 2008 respectively. Based on a review of the management accounts, Cavendish's ability to cover its maintenance costs and incremental overheads is uncertain and inconclusive, given the questions over the reliability of the management accounts in presenting an accurate account of Cavendish's financial performance. In the absence of accurate cost data for Cavendish, we assessed whether Cavendish could be considered a profitable operation in further detail in Appendix H, based on alternative data sources for both Cavendish's revenue and costs.

13. During the period from 1 August 2008 to 5 January 2009 (ie the acquisition completion date), which effectively covers the first five months of Cavendish's financial year ending 31 July 2009, the management accounts show that Cavendish generated revenues of £[✂], of which [✂] per cent was derived from concessionary fares (up from [✂] per cent in 2008) and [✂] per cent from daily bus cash takings (down from [✂] per cent in 2008). This period reflects Cavendish's increased peak service levels, which we understand accounted for the bulk of the significant increase in revenues.

14. Based on these figures, Cavendish's operating profit margin decreased from [✂] per cent for the financial year ended 31 July 2008 to [✂] per cent for the period to 5 January 2009. The change in its profitability was largely cost driven, as evidenced by a disproportionate increase in its driver and fuel costs relative to its increase in revenues, with total direct costs accounting for [✂] per cent of total revenues in the period to 5 January 2009, up from [✂] per cent in 2008. Whilst driver costs accounted for around [✂] per cent of total revenues in 2008, they increased to around [✂] per cent for the period to 5 January 2009. Gross profit margin for the period was [✂] per cent, down from [✂] per cent in the previous financial year. Overhead costs also increased during the period, accounting for [✂] per cent of total revenues compared with [✂] per cent in the previous financial year, with the largest increase in overheads coming from miscellaneous wage and other motor expenses.

15. In the four full months to 30 November 2008 (ie excluding the period from 1 December 2008 to 5 January 2009), Cavendish generated operating losses of £[✂] on revenues of £[✂].

16. Table 3 presents Cavendish's historic balance sheets as at 31 July 2007 to 5 January 2009 (Cavendish's acquisition completion date).

TABLE 3 **Cavendish: balance sheet (management accounts) as at 31 July 2007 to 5 January 2009**

			£'000
	2007	*2008*	*2009 5 Jan 09*
Fixed assets			
Tangible assets	[✄]	[✄]	[✄]
Current assets			
Debtors & prepayments & other	[✄]	[✄]	[✄]
Renown Coaches	[✄]	[✄]	[✄]
Director's current account	[✄]	[✄]	[✄]
	[✄]	[✄]	[✄]
Current liabilities			
Creditors & accruals	[✄]	[✄]	[✄]
Bank account	[✄]	[✄]	[✄]
	[✄]	[✄]	[✄]
Current assets – current liabilities	[✄]	[✄]	[✄]
Current assets/current liabilities (times)	[✄]	[✄]	[✄]
Net assets	[✄]	[✄]	[✄]

Source: Cavendish management accounts.

17. Based on the management accounts, Cavendish's balance sheet includes a number of items relating to Renown and its owner (ie Renown cash and Director's current account). However, in the absence of pure stand-alone financial statements for Cavendish, we have presented the balance sheet as set out in the management accounts, given that this would have been consistent with how Renown intended to operate and fund Cavendish at the time.

18. As at 31 July 2008, Cavendish's current assets were [✄] times its current liabilities, an increase on [✄] times in the prior year. We noted that this ratio substantially fell to [✄] times for the period from 1 August 2008 to 5 January 2009, during which Cavendish was operating its increased peak services.

Financial performance of Stagecoach

Introduction

1. Stagecoach, which is listed on the London Stock Exchange with a market capitalization of about £1 billion, is the ultimate parent company for Stagecoach Bus Holdings Limited and its operating unit, Stagecoach in East Kent and East Sussex. For the financial year ended 30 April 2009, Stagecoach generated revenues of £2,103.3 million (2008: £1,763.6 million), most of which was derived from its UK operations. Stagecoach Bus Holdings Limited, a wholly-owned subsidiary of Stagecoach, generated revenues of £[✂] million in 2009 (2008: £[✂] million).

2. Whilst Stagecoach Bus Holdings Limited was the vehicle which acquired both EBL and Cavendish, we have focused on the financial performance of Stagecoach in East Kent and East Sussex, the relevant operating unit into which EBL and Cavendish were integrated post-acquisition.

3. Stagecoach used to operate in Eastbourne as a result of its acquisition of Southdown Motor Services Limited in August 1989, but it closed its Eastbourne depot in 2002 and the depot site was subsequently developed for other purposes. Some of its routes were sold to EBL. In 2005, Stagecoach closed its Lewes depot, and sold its service 12 (Brighton to Eastbourne) to Brighton & Hove, which is part of Go-Ahead, along with most of the operations of its Lewes depot amounting to 15 vehicles and routes to Tunbridge Wells and Brighton.

Stagecoach in East Kent & East Sussex—historic financial performance

4. Stagecoach in East Kent and East Sussex is the relevant operating unit, which, following the acquisitions of EBL and Cavendish, is responsible for operating Stagecoach's local bus services in Eastbourne. Formerly Stagecoach in East Kent and Hastings, it employs around 900 staff and runs a fleet of about 325 buses from six depots across the region (at Herne Bay, Thanet, Dover, Ashford, Folkestone and Hastings). The business carries around 37 million passengers a year on over 80 different routes with some routes extending to Eastbourne and Maidstone. For the financial year ended 30 April 2009, Stagecoach in East Kent and East Sussex generated revenues of about £[✂] million (2008: £[✂] million), which accounts for less than [✂] per cent of Stagecoach's total revenues. Its historic profit and loss performance from financial year ended 30 April 2005 to 2009 is presented in Table 1.

TABLE 1 **Stagecoach in East Kent and East Sussex: profit and loss (management accounts), financial years ended 30 April 2005 to 2009**

£'000

	2005	*2006*	*2007*	*2008*	*2009*
Revenues					
On-bus commercial/tender	[✂]	[✂]	[✂]	[✂]	[✂]
Off-bus sales	[✂]	[✂]	[✂]	[✂]	[✂]
Concessionary	[✂]	[✂]	[✂]	[✂]	[✂]
Scholars	[✂]	[✂]	[✂]	[✂]	[✂]
Tender	[✂]	[✂]	[✂]	[✂]	[✂]
Total local bus	[✂]	[✂]	[✂]	[✂]	[✂]
Contracts	[✂]	[✂]	[✂]	[✂]	[✂]
National Express	[✂]	[✂]	[✂]	[✂]	[✂]
Hires & excursions	[✂]	[✂]	[✂]	[✂]	[✂]
Miscellaneous	[✂]	[✂]	[✂]	[✂]	[✂]
Total other revenues	[✂]	[✂]	[✂]	[✂]	[✂]
Total revenues	[✂]	[✂]	[✂]	[✂]	[✂]
Costs					
Drivers costs	[✂]	[✂]	[✂]	[✂]	[✂]
Fuel	[✂]	[✂]	[✂]	[✂]	[✂]
Bus service operators grant	[✂]	[✂]	[✂]	[✂]	[✂]
PSV insurance	[✂]	[✂]	[✂]	[✂]	[✂]
Other direct costs	[✂]	[✂]	[✂]	[✂]	[✂]
Engineering costs	[✂]	[✂]	[✂]	[✂]	[✂]
Operational costs	[✂]	[✂]	[✂]	[✂]	[✂]
Depot overheads	[✂]	[✂]	[✂]	[✂]	[✂]
Head office overheads	[✂]	[✂]	[✂]	[✂]	[✂]
Total costs (excl depreciation)	[✂]	[✂]	[✂]	[✂]	[✂]
EBITDA	[✂]	[✂]	[✂]	[✂]	[✂]
Depreciation	[✂]	[✂]	[✂]	[✂]	[✂]
Operating profit	[✂]	[✂]	[✂]	[✂]	[✂]
Margin (%)	[✂]	[✂]	[✂]	[✂]	[✂]
Total passengers ('000)	[✂]	[✂]	[✂]	[✂]	[✂]
Total mileage ('000)	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Stagecoach in East Kent and East Sussex management accounts.

5. Based on Table 1, Stagecoach in East Kent and East Sussex has demonstrated a good track record in growing revenues, driven by both organic and acquisition-led growth. Between 2005 and 2009, the business grew total revenues on average by around 7 per cent[1] a year, with average annual growth in passenger numbers of 6 per cent. Revenues in 2007 were impacted by the introduction of free concessionary travel in 2006/07, which resulted in revenues from concessionary fares increasing from £[✂] million in 2006 to £[✂] million. There was a corresponding reduction in on-bus revenues from £[✂] million in 2006 to £[✂] million in 2007. Combined revenues from concessionary and on-bus revenues increased from £[✂] million in 2006 to £[✂] million in 2007.

6. Stagecoach stated that it had been successful in growing concessionary passenger bus use since the introduction of the free concessionary travel scheme including the 2008 national scheme. Between 2007 and 2009, Stagecoach in East Kent and East Sussex increased concessionary fare revenues by an average 28 per cent a year. This compares to average growth of 7 per cent a year for on-bus revenues over the same period.

7. Total costs (including both direct costs and overheads) account for around [✂] per cent of total revenues and have remained broadly stable at that level over the period.

[1]All average annual growth rates based on compound annual growth rate calculations.

Drivers costs account for around [✂] per cent of total revenues, with net fuel costs accounting for between [✂] and [✂] per cent of total revenues. Stagecoach in East Kent and East Sussex has maintained a relatively stable cost base relative to its revenue growth, albeit total costs as a percentage of revenues have slightly fallen over the period, resulting in operating profit margins increasing from [✂] per cent in 2005 to [✂] per cent in 2009.

The regulation of buses and subsidized schemes

Introduction

1. This appendix summarizes the role of local authorities and the Traffic Commissioners when regulating bus services. It also sets out the reimbursement system for concessionary fares.

The requirements for a bus operating licence

2. Each bus operator needs to apply for a public service vehicle (PSV) operator's licence from a Traffic Commissioner and must meet a number of statutory criteria for eligibility. To be eligible for an operator's licence the applicant must be of good repute, have appropriate financial standing and be professionally competent.

3. Good repute can be established by satisfying the Traffic Commissioner that the operator, its servants or agents do not have relevant convictions recorded against them and that there are no other relevant matters as set out in the schedule to the Public Passenger Vehicles Act 1981 (as amended).

4. The test of appropriate financial standing is fixed by EC regulation and the figures are established by the Secretary of State for Transport. The Traffic Commissioner needs to be satisfied that an operator has sufficient finance to run a business properly. Traffic Commissioners have issued a practice direction which took effect from 1 January 2005. The practice direction states that for a standard national licence the financial requirements will be met though demonstrating funds of £6,200 for the first vehicle and £3,400 for each additional vehicle.

5. The test for professional competence is satisfied by an operator (or its transport manager) holding a certificate of professional competence.

6. In addition to satisfying the three statutory tests set out above, an operator must also establish that there will be adequate facilities or arrangements to ensure that its buses are maintained properly in the interests of road safety and that it is capable of securing compliance with the law relating to the driving or operating of registered bus services.

7. Operators' licences do not have an expiry date but are subject to the payment of annual or five-yearly fees and a five-year licence review. The Traffic Commissioner is required to impose a condition limiting the number of vehicles that can be operated simultaneously under the licence. The operator is then issued with the number of operator's discs it requires (up to the maximum number allowed in the licence) and one of these must be displayed beside the tax disc on each vehicle when a bus is being used under the licence. A variation application must be made if the operator wants to increase the maximum number of buses it may operate at the same time.

Traffic Commissioners

8. A Traffic Commissioner is appointed by the Secretary of State for Transport as an independent regulator for each of eight traffic areas. The Traffic Commissioner's

principal role is to ensure compliance with the principles of road safety and fair competition.[1] Eastbourne is in the South Eastern Traffic Area. Traffic Commissioners act as licensing authorities for the heavy goods vehicle (HGV) and PSV industries. The Traffic Commissioner has no control over bus and coach fares.

9. A Traffic Commissioner, when discharging regulatory functions, acts in a judicial capacity as a single person tribunal. Regulatory action may be taken against non-compliant operators. Where the Traffic Commissioner finds that the operator has been at fault, regulatory action may be taken. Many cases of non-compliance relate to poor maintenance of an operator's vehicles.

10. In some cases, the Traffic Commissioner may attach a condition which prevents an operator from operating local services on certain routes or from providing local bus services of any description.[2] This includes cases where the operator has failed to run its services as registered, has failed to comply with the requirements of a quality partnership scheme, has interfered with another operator's services or has operated dangerously. If an operator fails to run a local registered service in accordance with the statutory provisions, the Traffic Commissioner may impose a financial penalty.[3]

11. Operators are required to comply with the timetables they have submitted. The Traffic Commissioners have published a direction on bus standards. It states that for non-frequent services (ie more than a 10-minute gap between services), they expect bus operators to work to a target of 95 per cent of their timetabled services leaving the timing points for the route within the accepted tolerance of 'up to 1 minute early or up to 5 minutes late'. An operator will always have the opportunity to submit to a Traffic Commissioner that there was a 'reasonable excuse' for a bus failing to run to its registered timetable.

12. The Traffic Commissioner told us that no adverse findings had been made with regard to the repute of either EBL or Cavendish. However, there had been maintenance issues related to EBL and issues with punctuality relating to both companies. He had found against both companies in recent cases: Cavendish was fined for failing to run buses according to timetable, deviating from the registered route and depositing passengers away from authorized stops (6 September 2007); EBL was fined for failing to operate services according to timetable (28 November 2007). Stagecoach also told us that both EBL and Cavendish had experienced problems of reliability, because drivers or buses were unavailable, and punctuality through poor planning.

Registration of local bus services

13. Under the Transport Act 1985, an operator can provide a new local bus service after giving 56 days' notice to the Traffic Commissioner (in special circumstances the Traffic Commissioner can use discretion to accept a shorter period of notice). There is no need for any 'approval', but the operator has to provide the statutory particulars and other information that the Traffic Commissioner reasonably requires. If an oper-

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[1] Traffic Commissioners also have duties in respect of 'traffic regulation conditions', which do not currently apply in the Eastbourne area.
[2] Section 26 of the Transport Act 1995 (as amended by the Local Transport Act 2008).
[3] The maximum financial penalty which a Traffic Commissioner may impose is £550 multiplied by the number of vehicles which are authorized on an operator's licence. Each case is assessed on its merits by the Traffic Commissioner using the guidance set out in the Traffic Commissioners' Practice Direction number 4, issued in November 2004. In reaching a decision, the Traffic Commissioner will apply their judicial discretion.

ator wishes to vary or cancel a service, the operator must again give 56 days' notice. Traffic Commissioners publish details of bus service registrations fortnightly.[4]

14. Operators have to provide their Traffic Commissioner and the relevant local authorities with information about each proposed route, including its starting and finishing points, a map, the timetable (or a statement that the service interval will be 10 minutes or less) and stopping arrangements.[5] The timetable has to show timing points at principal points on the route.

Local authority powers

15. This section summarizes the role of local authorities in relation to bus services. Local authorities have a statutory duty to produce a Local Transport Plan setting out an integrated approach to transport facilities in their areas. Local authorities also have powers, as roads and traffic authorities, to manage traffic. As well as direct measures, such as bus lanes, that give priority to buses, other traffic management policies, including parking policy and congestion control measures, may significantly improve the relative competitiveness of bus services compared with trains and cars in areas where these policies are advanced.

16. The Local Transport Act 2000 (as amended by the Local Transport Act 2008) gave local authorities new powers. In particular, a local authority may:

- agree voluntary partnership agreements with local transport operators;
- make statutory quality partnership schemes;
- make quality contract schemes with local transport operators (under certain circumstances); and
- make statutory ticketing schemes.

17. We understand that none of these schemes currently applies in the Eastbourne area, with the exception of a voluntary partnership agreement. Voluntary partnership agreements existed prior to 2000 and often set out the provision of improved infrastructure such as bus shelters, bus stations and bus lanes in return for operators providing bus services of a particular standard, for example by introducing modern low-floor buses. There is a voluntary bus partnership agreement between ESCC, EBC and Wealden District Council with EBL and Stagecoach. The commitments of the voluntary partnership are set out in Annex 1, although we understand that a lack of resources and commitment have meant that the objectives of this partnership have not yet been advanced. We understand that ESCC, Stagecoach and EBC are interested to revive the objectives of this partnership agreement, although this is on hold pending the outcome of this inquiry.

Subsidized bus services

18. Local authorities are no longer able to provide general financial support for bus services in their areas. However, under the Local Transport Act 1985 county councils have a duty, and district councils have power, to secure the provision of public transport services that they consider appropriate to meet social needs and that would not otherwise be available. Under the 1996 Education Act, local authorities can secure

[4] In *Notices and Proceedings* available from the Vehicle and Operator Services Agency at www.vosa.gov.uk.
[5] If there are potential road safety or congestion problems, the local authorities may put restrictions on the roads being used.

the provision of school buses. Local authorities that wish to subsidize local bus services must generally invite tenders and, when deciding which (if any) tender to accept, must have regard to a combination of economy, efficiency and effectiveness; the implementation of the policies set out in the Local Transport Plan; and the reduction or limitation of traffic congestion, noise or air pollution.[6] Furthermore, where tenders are in excess of EC financial limits the local authority must comply with the EC procurement rules.

19. There are two main types of contract for tendered services:

- cost based: the local authority receives the revenue and the contractor tenders for the whole cost of operating the contract (ie revenue risk is taken by the authority); and

- subsidy based: the operator retains the revenue and tenders for the cost of operating the service less the estimated revenue (ie revenue risk is taken by the operator).

20. The contract usually specifies the details of the service, including the type of buses (including age), route and timetable, and may specify the fares (or a range of fares). Most contracts include clauses allowing them to be suspended if another operator decides to register the service commercially. We discuss subsidized school routes and tendered services more generally in Appendix F.

Concessionary fares

21. For many years, local authorities have provided concessionary fares for elderly and disabled people. Local authorities have the power to make concessionary schemes with the objective of providing compensation to operators such that they are no better and no worse off as a result of the scheme.

22. The Eastbourne area has had a concessionary fare scheme in place since 1987 which allowed local concessionary pass holders free local urban trips and half-price trips around East Sussex. The 2000 Act imposed a duty on district councils to issue, on application and free of charge, travel concession permits to people residing in their area who are aged 60 and over or disabled.[7] This has been extended to travel throughout England by the Concessionary Bus Travel Act 2007, which was a major change to the concessionary fare scheme that has resulted in significantly greater concessionary fare patronage. The provisions in the Act apply from 1 April 2008 and provide for free bus travel for those eligible from 9.30 am until 11.00 pm weekdays and all day weekends and bank holidays, across England. EBC has extended the scheme to apply from 9.00 am for travel by Eastbourne pass holders for journeys starting within the borough.

23. EBC is responsible for setting up and administering the concessionary fares scheme in Eastbourne, although, as is common practice, the administration has been dele-

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[6]Tenders are not required under the 1985 Act where action is urgently required for the purpose of: maintaining an existing service; securing a service which has ceased to exist; or securing a service to meet a public transport requirement which has arisen unexpectedly and ought to be met without delay. The agreement must not remain in force for more than three months and the local authority must invite tenders as soon as possible. There is also an exemption based on the authority's forecast expenditure on service subsidies. An agreement is exempt from the tender requirements if the subsidies under the agreement and the amount payable under other non-tendered service subsidy agreements for the financial year in which the agreement is made do not exceed one-quarter of the authority's forecast for that year. If the agreement remains in force after the end of the year, subsidies payable under it in any subsequent year must not exceed one-quarter of the forecast expenditure on service subsidies for that year. Furthermore, the exemption does not apply to an agreement for more than five years.
[7]As a result of the 2000 Act and the Travel Concessions (Eligibility) Act 2002.

gated to ESCC to share the administration costs and build expertise on a regional basis.[8] ESCC in turn contracts the calculation and administration of the concessionary fare scheme to the consultancy firm MCL, which administers similar schemes for 14 other transport areas around England. The government funding is thus collected by EBC and ESCC and distributed to bus operators through the administration of ESCC.[9]

24. The national scheme was slightly revised to change the way that concessionary fare journeys are recorded with application since 1 April 2008. Prior to 2008, relevant journeys were allowed and recorded on the basis of whether the concessionary pass holder was a resident in the scheme area of East and West Sussex and the city of Brighton & Hove. This system was amended so that relevant journeys are recorded on the basis of where the journey originates (this change was essential as the national scheme allows travel by concessionary pass holders from anywhere in England). In the Eastbourne area there has been a large increase in the number of concessionary journeys that were paid out by ESCC, although the system change has generally reduced the number of journeys paid out by rural local authorities. The relative changes in Eastbourne and Sussex generally are presented in Table 1.

TABLE 1 **Number of concessionary fare journeys reimbursed in the Eastbourne and Sussex areas**

	Eastbourne	*Sussex*
2006/07	1,748,829	20,688,340
2007/08	1,975,582	23,750,000
2008/09	2,794,717	27,070,000

Source: MCL.

25. In the Eastbourne area bus operators are reimbursed for concessionary travel pursuant to the Sussex Countywide Concessionary Travel Scheme. This scheme sets out the payment schedule for operators and a formula for reimbursement of concessionary fares. Most concessionary fares originating in Eastbourne are reimbursed at a rate of around 50 per cent of the average commercial fare plus a further 13p per pass-holder passenger to cover additional costs. Further detail on the scheme is described in Annex 2.

26. There is no general concessionary scheme for children operating in East Sussex. For those not entitled to free statutory travel, the Council operates a scheme whereby children can purchase a weekly ticket (seven days) for unlimited travel in East Sussex. There are two:

- The East Sussex Freedom Ticket scheme which costs £13.50 for weekly travel on participating operators' bus services in East Sussex (all bus operators in the Eastbourne area have participated). Freedom Tickets are available to children under 16, or those in full-time education, or those attending adult education classes.

[8]Any local authority can run its own transport scheme rather than opting to be part of the county scheme. This approach is likely to increase the administrative costs for the authorities (because they lose the economies of scale from joining the county scheme) and require that they directly negotiate and address any concerns raised by a bus operator, and handle any bus operator appeals that might have significant professional support. We are aware that Brighton & Hove Council is not part of the Sussex Countywide Concessionary Scheme.

[9]We were told that the funding for the national scheme comes from three sources: Communities and Local Government provides a revenue support grant to local authorities for local transport including concessionary fares and local authorities can also supplement this through council tax, and the Department for Transport (DfT) provides around £220 million to transport areas to fund the additional costs of the national concessionary scheme. Overall spending by local authorities on the scheme is around £1 billion.

- The East Sussex Pathfinder Ticket scheme is for 16–19 year olds in full-time education for weekly travel on participating operators' bus services in East Sussex (all bus operators in the Eastbourne area have participated). It costs service users £11.50 a week.

27. The weekly Freedom Ticket is issued only 'on bus' with the operator retaining the ticket income. A season ticket version of Freedom is also available to pupils and students entitled to free travel. The Freedom season tickets are issued by ESCC, which reimburses operators for the notional value of trips allocated on their commercial services. The rates agreed with individual operators are indicative of the average revenue forgone by each operator for a return trip on schooldays. The participating bus operators are able to claim a top-up payment of £3 per weekly ticket issue from the Pathfinder grant funding held by ESCC. The cost of these tickets is currently higher than the child's fare for Stagecoach's Megarider weekly ticket valid in the Eastbourne area. In general, it is standard bus industry practice for operators to offer child fares at around a 50 per cent discount to adult commercial fares.

28. ESCC also provides home-to-school transport for pupils and students who are eligible under the Education Act 1996, such as very low income families.[10] This is carried out either by operation of specific bus, coach or taxi contract or by purchase of bus or train passes used on the passenger transport network as appropriate. ESCC supports a number of tendered services primarily for school or college transport (passengers on tendered services still need to purchase tickets or to possess a valid pass); operators include Stagecoach/EBL and Renown. The income from home-to-school transport can be important for commercial operators, although it forms only a small part of EBL's current turnover.

Costs and administration of the concessionary fare scheme

29. The recent changes to the concessionary fare scheme, in particular since 2008, have been controversial from the perspective of bus operators, local authorities and the DfT. We are aware that there is a major review of the funding and reimbursement arrangements for concessionary travel being undertaken to simplify the systems to increase transparency and reduce the cost of the scheme. This review is intended to result in a revised system from 2011/12.

30. Bus operators have been concerned that they are not being sufficiently reimbursed for the cost of the concessionary passengers they are carrying. We understand that there are currently 47 appeals by bus operators to the Secretary of State in respect of schemes for the year 2009/10.

31. Local authorities are also concerned about the way they are funded for concessionary travel that originates in their region. As fares are now reimbursed on a point of origin basis (previously it was based on reimbursing on the cost of local concessionary card holders), some regions now have a greater number of journeys occurring in their region. This has been particularly noticeable in the areas associated with higher elderly populations and/or high levels of elderly visitors and the increasing number of journeys being reimbursed in Eastbourne is consistent with this understanding. However, it is less clear whether those local authorities with increasing numbers of journeys are worse off as a result. We are aware that a number of authorities (EBC included) have contested the level of national funding they have received to pay for concessionary travel. These concerns have not led to any changes in funding for the current year, although there is currently a consultation on changing the local authority

[10]The Education Act 1996 consolidated the Education Act 1944.

tier at which funding is provided. The DfT review on the reimbursement arrangements for the concessionary scheme is intended to make the funding process more transparent and standard.

32. The DfT has provided guidance for local authorities to administer the concessionary scheme, although it does not specify how it must operate. This has resulted in many different schemes around England.

Implications of the concessionary fare scheme for bus operator incentives

33. It is intended that no bus operator is in a better or worse position under the concessionary fare scheme; broadly the principle is that operators should make no more or less profit than if the scheme was not in existence and all passengers paid commercial fares. Operators are reimbursed only a proportion of commercial fares in recognition of the fact that the free travel entitlement will have stimulated more passenger journeys. However, the revenue gained from the concessionary fare scheme is influenced by the commercial fares charged by a bus operator and an issue is raised as to whether the concessionary fare scheme might enhance or diminish any incentive that a bus operator might have to raise its fares in response to a change in the nature of competition.

34. It might be expected that because *(a)* concessionary fare reimbursement will reflect the increase in commercial fares, and *(b)* there will be no reduction in demand because passengers do not bear any higher costs, the effect will be to decrease overall passenger sensitivity to fares, and this more price inelastic demand will create an incentive to increase fares to a higher level. However, there are potential checks built into the system.

35. First, if fares increase above inflation,[11] there is an adjustment made to the calculation of reimbursement rates in subsequent years, because it is assumed that higher fares would have resulted in fewer of the concessionary passengers travelling when faced with higher commercial fares. However, this measure is applied at the level of the whole scheme, and is not applied at the level of the individual bus operator.

36. Second, if fares increased out of line with other operators, the scheme administrator, MCL, told us that under the terms of the Sussex scheme, this comparison could trigger a review. It said that it would then be open to MCL to reduce the particular individual operator's fares to an average of other operators of similar services, as a reasonable proxy. Stagecoach told us that this could be achieved by the administrator adjusting the notional commercial fare basket, by assuming a greater proportionate use of discounted tickets, but MCL disagreed; it told us that the calculation of the notional commercial fare basket was based on actual sales and agreed with the operator.

37. Exactly when a review would be triggered is unclear, and there is no guidance on the principles which can be followed on such a case (although DfT guidance specifically says that payments on the no better/no worse principle should be calculated without regard to the financial impact on the authority). We understand that MCL, which administers schemes in 14 transport areas, has never identified any operator's fares as being significantly out of line with the fares of others, and so has not had reason to challenge an operator's fare structure as being unreasonable. It told us that it undertakes surveys of fare structures to support its average fare calculations. The DfT also

[11]MCL said that fares generally tended to rise in line with bus industry costs, which often significantly exceed general inflation rates.

made the point that it was not aware of any average fare increases being challenged in this way.

38. Consequently, how a challenge to a fare increase would be applied in practice, if at all, remains unclear. It is possible that a small increase in an operator's fare structure would be unlikely to warrant a challenge by MCL, on the basis that no past fare increases have been challenged and such an increase may not be judged exceptional when viewed in the context of generally increasing fare levels. Therefore, whether the operation of the scheme would offset to a greater or lesser extent any increase in concessionary revenues received by a particular bus operator in the event of a significant increase in commercial fares is not certain.

39. The DfT told us that there were no specific tools built into the system specifically to limit the budgetary cost of concessionary travel. It said that the majority of funding for concessionary travel came from the Communities and Local Government Department's formula grant to local authorities, and so there was not a specific hypothecated budget to control. It told us that the Reimbursement Analysis Tool, and provision of guidance at a national level, were designed to assist in the objective of making the scheme 'no better, no worse off'. These do not appear to act as a disincentive to increase fares at the level of the individual bus operator. The annual reimbursement factor provided by the Local Authority (except where an appeal is made) usually reduces annually, but the DfT said that this was in part to counter the effect of increasing commercial fares and largely to reflect the fact that long-run elasticities were larger than short-run elasticities, rather than being a budgetary control measure.

Bus service operators' grant

40. Immediately after deregulation, the only form of subsidy available to commercially-operated local bus services was fuel duty rebate. Operators of registered local bus services received a grant which offset a substantial part of the duty paid on the fuel used in running local bus services. The Local Transport Act 2000 replaced this grant with the 'bus service operators' grant' which again reimburses most of the fuel duty (all for new cleaner fuels) paid by the operators, although changes are now being made to the basis for this subsidy payment.

Commitments under the Eastbourne voluntary bus partnership agreement

1. The Eastbourne voluntary partnership agreement (also referred to as a (non-statutory) quality bus partnership) sets out that each of the partners to the agreement subscribes to the following commitments and will use their best endeavours to achieve the following aims:[12]

(a) To improve the reliability, punctuality and frequency of bus services, provide improvements to passenger waiting facilities and passenger information and to improve the coordination of public transport services across the Eastbourne area.

(b) To ensure that the Eastbourne area bus network develops in a way that furthers the achievement of the Local Transport Plan, compliments the Eastbourne decriminalized parking scheme proposals and supports the developing regeneration and transport strategies in the area. This will aid the long-term planning of sustainable public transport services and reduce car dependence.

(c) To improve frequencies on key routes and to explore innovative ways of developing a complementary network of services that meets the needs of people who are not served by the core network.

(d) To improve the bus fleet by reducing the average age of buses and increasing the number of easy-access low-floor buses, with low emission engines.

(e) To develop a Passengers' Charter and Customer Care standards to improve the quality of the bus service, incorporating staff training and development to achieve recognized NVQ qualifications and better disability awareness.

(f) To develop Quality Bus Corridor schemes and infrastructure improvements incorporating bus priority measures and improved passenger facilities in the Eastbourne area to assist the bus operators achieve fast, frequent and punctual bus services.

(g) Initially two main bus corridors or Quality Bus Corridors will be developed:[13]

   a. Langney Shopping Centre–Eastbourne Town Centre; and

   b. Polegate/Wannock Crossroads–Eastbourne Town Centre.

(h) To introduce real-time bus information and a GPS-based Bus Management System. New technology will be used to make improvements to the bus service and to measure the performance of the bus network.

(i) To develop marketing campaigns to promote the bus services, including better passenger information, ticketing schemes and fares initiatives. In addition, to develop better access to passenger information by conventional means and via new technology, such as the Internet and mobile phones.

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[12] As dated 15 July 2004 and posted to EBC website 13 February 2006. Stagecoach told us that this agreement had been dormant, although ESCC indicated that it was keen to develop the Quality Bus Partnership with Stagecoach.
[13] The Local Transport Plan now identifies the following roads within Eastbourne as quality bus corridors: *(a)* A529 Seaside; *(b)* A2021 Kings Drive; *(c)* A2270 Willingdon Road/Upperton Road. The A2021 and A2270 both run from Polegate/Wannock Crossroads to the Eastbourne Town Centre.

(j) To consult the public on improvements to the bus service, infrastructure and provision of information.

(k) To implement schemes with specific funding, ie the Westham and Pevensey Rural Bus Challenge Scheme, and to identify future sources of funding to develop and implement schemes.

(l) To develop travel plans with businesses and organizations in the Eastbourne area and to develop initiatives to encourage increased bus usage.

(m) To develop and adopt by September 2004 a detailed three-year Action Plan and performance monitoring measures. To periodically roll forward the Action Plan and make copies of the Action Plan widely available.

(n) To meet on a regular basis to review progress and to set future aims and objectives.

Sussex Countrywide Concessionary Travel Scheme

1. The details of the scheme explain that bus operators are entitled to a monthly payment in advance, on the first of each month, equivalent to 95 per cent of 1/12 of the 'Total Reimbursement'. The Total Reimbursement is the annual sum of the Revenue Reimbursement, Standard Additional Costs and Additional Capacity Costs. Each of these elements of this formula is set out below.

2. The Revenue Reimbursement is the majority of the payment and is calculated pursuant to the formula set out below, which allows for the different value of types of fares and also the environment of the journey (and hence estimates of different price sensitivities for different types of service). In summary, this formula is calculated from an average fare (this is calculated from the range of fares charged by a bus operator —a single counts as one and returns as two fares and these fares are then discounted to allow for the discounting effect of multi-ticket and weekly passes etc— which is then discounted by a reimbursement factor to account for the different elasticities and generation of concessionary fare journeys in different types of area (large urban, small urban or rural etc) and finally multiplied by the number of concessionary journeys recorded by a particular bus operator.

$$R = J \times F \times f_r$$

Where:
R = Revenue Reimbursement.
J = the validated number of Passenger Journeys made in accordance with the Statutory and Discretionary Elements of the Scheme and starting in the Principal Area of the Scheme.
F = the average Normal Fare (this is calculated from the average adult fare per journey paid by fare paying passengers with that bus operator—single fares counting as one journey and returns as two journeys. This value is adjusted by means of a 'fares discount factor' to take account of other discounts that are normally available such as multi-tickets and weekly passes).
f_r = the Revenue Reimbursement Factor which takes account of Generated Travel. This factor will be applied according to the category of each service which will depend on such things as whether it is in a large or small urban or rural area and is reimbursed at the values provided (the Eastbourne area is categorized as Urban which is set at a reimbursement factor of 0.5290 and would be relevant for most concessionary fares generated by EBL).

3. The reimbursement factor used in the formula differs according to the category of each journey and normally decreases annually (in part as the full impact of free fares takes a number of years to work through due to fare increases—see paragraph 39).[14] The reimbursement factor generally used for Eastbourne would be under the category of 'Urban', although some operators in Eastbourne would be subject to different reimbursement categories, for example 'inter-urban' journeys such as Brighton–Eastbourne. These categories are set out in Table 2.

[14]The DfT provides advice on how to calculate revenue reimbursement factors, including the longer-run impacts of the scheme where local data is not available. The annual decrease in the Reimbursement Factor is for the first five years of the scheme based on DfT assumptions within the DfT Reimbursement Analysis tool (RAT). It is then assumed that a steady state is reached. This assumption is open to challenge in any particular scheme.

TABLE 2 **Reimbursement factors, 2009/10**

Category of service	*Description*	*Generated travel %*	*Reimbursement factor*
Large urban	Those services serving towns, cities or conurbations of more than 100,000 inhabitants, or towns, cities or conurbations of over 50,000 inhabitants with an identifiable internal network of bus routes	111.4	0.4730
Urban	Those services serving towns of more than 15,000 inhabitants. Those services which serve both large urban, urban and rural areas and having 60% or more of passenger journeys within the urban area.	89.0	0.5290
Inter-urban	Those services serving two or more urban areas	154.5	0.3930
Rural	Those services running daily on weekdays with a regular frequency which either do not service any of the above urban areas or where they do serve an urban area, 40% or less of their passengers make journeys entirely within the urban area	69.5	0.5900
Rural infrequent	Those services running less than daily on weekdays which either do not serve any of the above urban areas or where they do serve an urban area, 40% or less of their passengers make journeys entirely within the urban area	44.1	0.6940
Special	Those services which provide irregular, infrequent or restricted availability, such as community buses, dial-a-rides, etc	23.0	0.8130

Source: The Sussex Countywide Concessionary Travel Scheme.

4. A supplement in respect of Standard Additional Costs will also be paid to bus operators.[15] This is set at £0.13 per generated journey for all of the operators in the Sussex Countywide Concessionary Travel Scheme from 1 April 2009 (it had previously been set at £0.12 from 1 April 2008).[16] In summary, this amount will be at least a minimum of £500 or 50 per cent of the Revenue Reimbursement (whichever is the lower) and is designed to compensate for those extra costs that might be expected to be incurred for additional passengers travelling as a result of the concessionary fare scheme. The £0.13 is limited to the journeys of concessionary passengers. This is set out by the following formula:

$$J_g = J \times g / (1 + g)$$

Where:
J_g = the number of generated journeys.
J = the validated number of Passenger Journeys.
g = the amount of generated travel (as set out in Table 2).

5. There may also be exceptional circumstances where existing load factors and the local level of generated travel are very high and extra capacity has to be provided which may be reimbursed as Additional Capacity Costs. This is available only where an operator can show that additional capacity has needed to be provided to meet the additional demand arising from concessionary fare passengers. We understand from MCL that this amount has not been claimed by any of the Eastbourne-based operators, although it has been claimed by other bus operators under the scheme. The amount paid under this element of the scheme can range from £1,000 annually to

[15]This figure is calculated from factors raised in negotiations such as: additional dwell times at stops for additional passengers; additional stops served for additional passengers; increased fuel consumptions due to extra weight; ticket costs; increased insurance claims arising from more users; and cost of providing timetable and telephone information.
[16]The DfT has set out in its guidance that, where appropriate, Standard Additional Costs might range from £0.05 to £0.15 which is intended to approximate the marginal cost of additional concessionary fare passengers. The lower end of the scale represents the additional cost of each passenger. A higher reimbursement would reflect those costs expected from increasing services as a result of increasing numbers of concessionary fare passengers (a 0.5 per cent increase in services might be expected to increase cost by around £0.08 per concessionary passenger). We understand that across the 14 transport areas administered by MCL, all of them receive this reimbursement and the Standard Additional Cost ranges from £0.12 to £0.16.

£100,000, depending on the amount of additional capacity required to meet the demand. For example, it might be just providing a slightly larger bus or slightly more frequent services compared with entirely new routes and additional buses. Bus operators are required to prove that the additional capacity (and hence cost) is the direct result of additional concessionary passengers and not simply normal market growth. The DfT suggested that where 20–30 per cent of overall patronage is generated by the concessionary fare scheme, then it is plausible that the bus network and services would have been smaller after 9.30 am in the absence of the scheme. The DfT told us that claims for additional capacity cost reimbursement were becoming more prevalent and were the source of most of the controversy from bus operators in respect of the concessionary fares scheme.

6. At the end of every quarter a balance of payments made against payments due is undertaken and the bus operator will receive any additional sum shown by the reconciliation or have overpayments deducted by invoice or future payments.

Background to tendered services

1. Local authorities have powers to secure provision of socially necessary bus services that are not provided commercially, and school bus services (tendered services). ESCC procures these in East Sussex. From time to time (most commonly on an annual basis), ESCC issues specifications for tenders, ranging from a network of rural or small town routes requiring several buses, down to a single peak school journey. Some contracts require only parts of a route to be tendered.

2. Contracts for tendered services are of two main types:

   - cost based: the local authority receives the revenue and the contractor tenders for the whole cost of operating the contract (ie revenue risk is taken by the authority); and

   - subsidy based: the operator retains the revenue and tenders for the cost of operating the service less the estimated revenue (ie revenue risk is taken by the operator).

3. The contract usually specifies the details of the service, and the fares (or a range of fares); ESCC told us that these were usually set at a rate similar to commercial fares. Most contracts include clauses allowing them to be suspended if the requirements of the service change (for example, because demand for the service changes, which might emerge if another operator decides to register the service commercially).

4. Stagecoach noted that tendered services must be operated in accordance with the relevant conditions of contract; consequently it believed that the operator of a tendered service has very little discretion as to how it runs the service, and so it cannot compete with overlapping commercial services on the basis of price and/or frequency, as these are set by the local authority for a specific period. Once the contract is awarded, the operator's business is secured for the duration of the contract (although it may bare the revenue risk under a subsidy-based contract).

5. Therefore, in relation to tendered services, competition is for the market at the outset, for the right to operate tendered services through winning the tendering exercise. This is based on price and quality (in terms of service delivery considerations, for example types of vehicles to be used).

6. When ESCC issues a tender, operators are required to submit sealed bids by a given deadline including a price for the proposed operation, along with any suggestions they may have for minor adjustments to improve operational efficiency or passenger benefit, along with other details to confirm an ability to maintain roadside infrastructure (such as timetable displays), or certain vehicle specifications.

7. Stagecoach told us that there was significant competition among operators for ESCC local bus tenders. It said that tendered bus services attracted operators which welcomed the guaranteed income these contracts brought. Such services were often operated by smaller operators and ones without a network of commercial services. It said that EBL had for some years suffered a declining level of tendered operation as a result of such strong competition. EBL's tendered services as at 1 April 2009 are listed at Table 1. Stagecoach told us that since its acquisition of EBL, in a retendering exercise for services starting on 26 July 2009, it had been successful in retaining the

tenders for routes 56/57/58, but that it had lost the tenders for routes 53 (to Renown) and 261 (to Countryliner).

TABLE 1 **Tendered bus services operated by EBL, 1 April 2009**

Service number	*Type*	*No of days per year*		*Daily mileage (km)*	*Contract expiry date*	*Details*	*Previously*
53	Cost based	190	Schooldays only	68.4	25/7/2009	All journeys	EBL
261	Cost based	253	Mon–Fri	332.8	25/7/2009	All journeys	EBL (operated as extension of route 54)
261	Cost based	52	Saturday	274.2	25/7/2009	All journeys	EBL (operated as extension of route 54)
252	Cost based	190	Schooldays only	57.3	30/7/2011	Peak school journeys to Tunbridge Wells Bennet Memorial School	EBL (operated as route 52)
252	Cost based	190	Schooldays only	26.6	30/7/2011	pm peak journey from Heathfield College	EBL (operated as route 52)
252/52	Subsidy based	253	Mon–Fri	56.3	30/7/2011	1910 Tunbridge Wells–Eastbourne	EBL (operated as route 52)
51	Subsidy based	190	Schooldays only	7.7	25/7/2009	Schoolday pm diversion via Cavendish School	EBL (operated as part of route 5)
10	Subsidy based	253	Mon–Fri		?	Stone Cross–Beachlands	Cavendish Motor Services
58	Cost based	190	Schooldays only		25/7/2009	Willingdon Schools peak journeys	Cavendish Motor Services
56/7	Cost based	190	Schooldays only		25/7/2009	Willingdon Schools peak journeys	Cavendish Motor Services

Source: Stagecoach.

8. However, the discussion above reflects tendering throughout East Sussex; the value of tendered services in the Eastbourne area is limited. Stagecoach estimated that the value of on-bus revenue from tendered services in 2008 in the Eastbourne area was under £100,000, which was just [0–2] per cent of total commercial and tendered revenues, and arose on services operated solely by Renown and Cavendish.

Market definition

1. Introduction

1. In this appendix we set out our view on the market(s) that are relevant to the acquisition of EBL and Cavendish by Stagecoach. Market definition is not an end in itself, but is a valuable exercise for identifying competitive constraints. In what follows, we set out our views in relation to the key market definition issues including: the degree to which there is demand-side or supply-side substitution between flows; whether passengers value access to a network and therefore whether we need to define a 'network market'; and the degree to which other forms of transport, for example rail, taxis and cars, provide a competitive constraint.

2. There are typically two dimensions to the definition of a market: the product market, which should include all products that impose a significant competitive constraint on the product in question, and the geographic market, which should include all the neighbouring areas to which sufficient customers would switch to purchase the product or from which suppliers could 'import' the product to impose a constraint. In transport inquiries, the delineation between the product and geographic aspects of market definition is less clear-cut. For example, one can view purchasing a ticket for a journey from A to B by bus as an element of the product offering or as a geographic aspect of the offering, and we have for this purpose considered these two aspects together.

3. Wherever possible, the CC adopts the hypothetical monopolist test to define markets. A price-based hypothetical monopolist test (SSNIP test) involves starting with a narrow 'candidate' market and widening it until sufficient alternatives are included such that a hypothetical monopolist could profitably impose a small but significant non-transitory increase in price (SSNIP), which is typically 5 per cent. In this way, we ensure that all important competitive constraints are included within the market we define.

4. Stagecoach submitted that the SSNIP test was not appropriate for observing switching decisions in bus services (especially for passengers enjoying concessionary fares) because:

   (a) fares were not the only consideration for passengers; and

   (b) a 5 per cent increase was not particularly significant in monetary terms when talking about bus fares: in this regard, Stagecoach told us that it did not consider that a 5 per cent price rise would generally be sufficient to persuade passengers to switch between operators.

5. Stagecoach provided the following example to illustrate the second point: 'if there is a frequency of every 10 minutes on a route, with two operators each offering 3 buses per hour, evenly spaced, then for a customer to be willing to wait 10 minutes extra for a 10p price difference requires that their value of time is 1p per minute or less'. Stagecoach further submitted that this was a considerable way below estimates of the average value of time, for example Mackie et al (2003) which estimated that the value of time for non-commuter travellers was 5.9p per minute (in 1997 prices) and 6.6p per minute for commuters.

6. On the first point, we accept that fares are not the only factor taken into account by passengers, and that frequency in particular seems to be important to them.[1] However, this does not in our view invalidate the use of a SSNIP test. The evidence suggests that fares are an important driver of passenger demand[2] (indeed Stagecoach does not appear to be contesting this[3]) and for this reason we consider that it is still appropriate to conduct market definition using a SSNIP. In general, it is possible to conceive of the hypothetical monopolist test as a small but significant non-transitory worsening of fares, service quality (such as reductions in frequency, hours of operation or quality of the buses) or some combination of those factors; however, it can be difficult to make this operational. Where possible, we supplement our price-based hypothetical monopolist test by considering how demand would change as a result of deteriorations in non-price factors, in particular frequency.

7. On the second point, we do not accept the proposition that a 5 per cent price increase would be inappropriate for observing whether passengers would switch between operators. To the extent that most buses in Eastbourne run to a regular timetable, switching between operators is more likely to involve a passenger adjusting their arrival time at the bus stop rather than waiting at the bus stop for the rival service to arrive. This change could enable a passenger to save up to £30 spread across the year, depending on the frequency of use and ticket type purchased.[4]

8. We therefore adopt the SSNIP test, recognizing, however, that where practicable we should also consider relative changes in non-price factors.

9. The central issues we consider in this appendix in relation to market definition are:

   (a) whether markets should be defined by reference to a bus network as well as, or instead of, point-to-point flows or routes (Section 2);

   (b) to what extent services on flows which serve similar but non-identical origins and destinations can be regarded as being in competition with one another (Section 2);[5]

   (c) the likely reactions of bus operators in response to a change in market conditions, for example whether there is an effective constraint on individual flows or routes by virtue of an ability for other bus operators easily to enter on those flows or routes. If there is, then we need to consider whether it is appropriate to treat these other bus operators (or the flows or routes on which they are active) as already being part of the market, rather than as potential entrants (Section 2);

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[1]Renown told us that service frequency and reliability were more important factors than price and Arriva told us that replies from its annual surveys indicated that the key factors in retaining existing passengers were punctuality, reliability, frequency, value for money and the perception of being in a safe environment: fares did not automatically drive choice. Countryliner told us that competition on fare structures and prices, frequency, quality aspects including reliability and passenger safety were all important but that a reduction in service quality would cause more passengers to switch than price considerations.
[2]Go-Ahead told us that as a baseline punctuality and reliability were absolutely essential but that in some markets price was very important and in others quality, for example vehicle age, wi-fi access, air conditioning and high-backed seats. Rotala told us that generally passengers would get on the bus that arrived first unless there was a greater saving. First Group told us that competitive strategies could incorporate a combination of elements such as punctuality, customer service, vehicle quality and/or fare variations.
[3]Stagecoach told us that frequency and journey time 'are factors of quality of service which, along with price (for certain passengers) and other dimensions of quality of service, will be taken into account when passengers are choosing between options'. Stagecoach also told us that pre-merger competition between EBL and Cavendish was focused primarily on frequency of service and, to some extent, price and that Cavendish maintained its flat town adult single fare at least 20p lower than the equivalent EBL fare.
[4]For a passenger who undertook a return journey five days a week for 48 weeks a year, a 5 per cent price increase would represent in rough terms an increase of between £23 and £30 depending upon whether they purchased a weekly ticket or a return ticket. These figures assume a weekly ticket price of £9.50 and a return fare of £2.50, which were the fares charged by Cavendish in summer 2008. The figure would be higher if EBL fares were used.
[5]We consider to what extent services on flows which run to different timetables and/or offer different frequencies can be regarded as being in competition with one another in Appendix I on overlap flows.

(d) whether the relevant market includes other types of public transport (such as trains or taxis), and/or private transport (particularly cars), and/or walking and cycling (Section 3);

(e) whether there is any relevant segmentation of the market, for example by passenger type (Section 4); and

(f) whether there is a separate market for the supply of tendered bus services (Section 5).

10. Eastbourne is noteworthy for having a high proportion of concessionary passengers: Stagecoach told us that, as of March 2009, there were 22,000 concessionary pass holders in Eastbourne; that the proportion of bus users holding concessionary passes in Eastbourne was around 45 per cent; and that EBL carried 1,635,840 concessionary passengers in 2008 compared with a total of 4,428,739 passengers, a proportion of 36.9 per cent. These pass holders are entitled to free bus travel between 9am and 11pm in the borough on weekdays, and all day weekends and bank holidays.[6] In the Eastbourne area, bus operators are reimbursed for concessionary travel through the Sussex Countrywide Concessionary Travel Scheme according to a reimbursement formula. More details on the operation of this scheme and the formula are set out in Appendix E; nevertheless it is worthwhile summarizing two key features that impact upon market definition here:

(a) The majority of the payment comes from the reimbursement formula which is the product of the average normal fare[7] charged by the individual bus operator, the number of concessionary passengers that are carried and the reimbursement factor (for the year 1 April 2009 to 31 March 2010 this is 0.5290 for urban services in the Eastbourne area[8]). We understand that the reimbursement factor is reduced on an annual basis. The DFT told us that this was mostly to reflect that the elasticity of demand for bus travel was higher in the long run than in the short run (hence over time, fewer commercial passengers would be travelling on commercial fares in the absence of the scheme), but it also counteracted the increasing national cost of the scheme which was a factor of increasing numbers of national concessionary journeys. We observe that it is common for operators to challenge legally the reimbursement rate (a legal challenge is made to the Secretary for State) in order to gain a larger reimbursement and that EBL has challenged the rate set for the current year.

(b) In principle, if the average fare were to increase out of line with other operators then a reasonable proxy could instead be paid by the local traffic authority (in the case of Eastbourne this is ESCC which delegates the administration to a consultancy company called MCL). However, it is not clear at what point a marginal increase in an operator's average fare would be considered sufficient to warrant a challenge by MCL (we understand that to date MCL has never had reason to reimburse at a lower proxy average fare rate). For the purposes of evaluating responses to a price-based SSNIP, we cannot assume with any certainty that the reactions of the local transport authority would fully or even partially mitigate 'small but significant' price increases, although it is possible that its response might impact upon the reimbursement rate.

[6]The Concessionary Bus Travel Act 2007 also provides that everyone aged 60 or over or disabled can obtain free off-peak travel on all local buses anywhere in England.
[7]This is calculated from the range of fares charged by a bus operator—a single counts as one and returns as two fares and these fares are then discounted to allow for the averaging effect of multi-ticket and weekly passes etc.
[8]The reimbursement factor for inter-urban services is 0.393.

11. Finally, it is useful to clarify the terminology that is being employed in this appendix. A 'route' is defined as an end-to-end service. Routes in the Eastbourne area are taken to include all routes that serve any location in the Eastbourne area even if they begin in, end in, or serve for the majority of their journey, locations outside the Eastbourne area. A 'flow' is defined as any connection between two specified points. Flows might correspond to an end-to-end route, but they might also correspond to shorter journeys between intermediate points on a route (eg bus stops or fare stages).

2. Consumer demand for bus services

The importance of a network

12. Passenger's demand is to travel from an origin (eg their home) to a destination (eg to work). However, whilst some passengers may only be interested in making one or a series of point-to-point journeys along a single route, others may be interested in making one or a series of multiple journeys across several distinct and possibly interconnecting routes. For the latter group of customers, the different routes are complements to one another (in so far as they will tend to make use of them together).[9] We therefore need to consider whether it is appropriate to define a 'network' market as a result of these demand-side complementarities. If the evidence indicates that there is a significant group of customers who value making network journeys and that they choose between operators when purchasing a 'network ticket', this would suggest that competition between networks (rather than over individual flows) is an important element of the process of rivalry. This has implications for our understanding of competition and also the nature of entry that needs to occur to replicate any loss of competition that might be identified: if competition between networks is important then new entrants will be likely to need to enter on a network scale (ie more than just on an individual route or a couple of routes) to be able to compete effectively.

13. Stagecoach argued that a network approach would not be appropriate for demand-side substitution given the features of the market in Eastbourne, and that it would be inconsistent with precedent for mergers involving operators of a single mode of transport.

14. According to Stagecoach, the majority of bus passengers travelling within Eastbourne used a single bus service only for their regular journeys. It told us that the small size of the town meant that the relevance of the network was minimal and the proportion of passengers switching bus services within a journey was insignificant.

15. The following table sets out the number of passenger journeys made using different ticket types for both EBL and Cavendish in the Eastbourne area for 2008.

[9] Technically, if two products are complements the cross-price elasticity between them is negative, ie if the price of one increases the demand for the complementary product will fall.

TABLE 1 **Number of passengers by ticket type for 2008**

	EBL			*Cavendish*		
	Number	*Total %*	*Fare paying %*	*Number*	*Total %*	*Fare paying %*
Multi-operator network tickets	[✂]	3	5	[✂]	0	0
Return tickets	[✂]	5	9	[✂]	9	23
Single tickets	[✂]	18	30	[✂]	21	56
Single-operator network tickets	[✂]	33	56	[✂]	8	21
Concessionary	[✂]	41	N/A	[✂]	62	N/A
Total	[✂]	100	N/A	[✂]	100	N/A

Source: Analysis of 2008 ticket data provided by Stagecoach and Renown.

Notes:
1. The main multi-operator network tickets were the Explorer, Freedom and Pathfinder tickets.
2. EBL's main network tickets were: daily and weekly tickets valid for unlimited travel over the entire EBL network, family tickets valid for travel as a family for one day in Eastbourne and 12-journey tickets which provide 12 journeys for the price of 10 singles.
3. Cavendish's main network tickets were: Green Rover day tickets and five-day/weekly tickets.
4. N/A = not applicable.

16. The data indicates that pre-merger, single-operator network tickets[10] were used by around one-third of EBL's passengers and 8 per cent of Cavendish's (or 56 per cent and 21 per cent of their fare-paying passengers).

17. Stagecoach told us that: the primary function of these 'network' tickets was as point-to-point season tickets, with the advantage that they were not user-specific; that route-specific season tickets were not available in Eastbourne and this was likely to drive network ticketing; and that during the first half of 2008, the price of an EBL day ticket was the same price or less than the price of a return ticket and drivers were instructed to issue day tickets instead of returns. It seems likely therefore that the proportion of passengers undertaking journeys on network tickets overestimates the proportion that actually values the ability to undertake journeys across the network, particularly for EBL. However, Stagecoach also told us that it was appropriate to assume that a passenger purchasing a day ticket would undertake approximately four journeys on that ticket.

18. Overall, the evidence on whether a significant group of customers within the Eastbourne area places value on demand complementarities between routes is not persuasive; network ticket sales may largely reflect the ticket pricing structures that have been adopted. Therefore we conclude that there is no separate network market for bus travel in the Eastbourne area.

19. Next we consider:

(a) to what extent can we consider flows that are in close proximity to one another as demand-side substitutes and within the same market; and

(b) how easy and quick is it for bus companies to 'enter' on each other's flows and the implications this has for market definition.

We discuss each of these in turn below.

[10]'Network tickets' include tickets valid for multiple journeys and daily or longer period zonal tickets that can be used on a number of different routes provided by the operator. Network tickets allow customers to travel across the local network by changing buses without paying again.

Demand-side substitution between flows

20. In relation to demand-side substitution between flows, Stagecoach submitted that passengers in Eastbourne were unlikely to change their route in response to a 5 to 10 per cent price rise (whether in the price of a route-specific ticket or a multi-journey ticket), unless there were routes that passed close to their origin and destination. In other words, unless there are two transport corridors which run parallel with each other, and are within walking distance of one another, passengers will not switch between different flows in response to such changes. The exact extent of this viable walking distance has not been determined by Stagecoach. However, in the specific context of Eastbourne, Stagecoach argued that there were few examples where passengers would be in a position to choose between different routes for their travel, largely because of the geography of the town.[11]

21. The National Travel Survey (2002) published by the Department for Transport (DfT) reports the average time taken to walk to the nearest bus stop by population size. In urban areas with a population of between 25,000 and 250,000 (Eastbourne has a population of just under 100,000), 89 per cent of bus passengers walk for 6 minutes or less to reach their bus stop, 9 per cent walk for between 7 and 13 minutes and only 2 per cent walk for 14 minutes or more. If we assume conservatively that all bus passengers walk a maximum of 6 minutes to reach their bus stop and that they walk at approximately 3 miles an hour (5 km an hour), then we can conclude that a typical bus stop will draw its passengers from a 500m radius. This suggests that flows that involve bus stops that are 1 km apart will have negligible competitive interaction with one another.

22. In the absence of information on the distribution of passengers within the 500m radii, it is difficult to determine how far apart two different flows need to be in terms of their start and end bus stops to be considered substitutable by passengers. However, reducing the distance between bus stops to 500m appears to increase the proportion of passengers in overlap areas (ie who could walk to/from either bus stop within the 6-minute walk time) to a significant proportion. If we assume an even distribution of customers, it transpires that, for each of the bus stops, close to 40 per cent of the passengers in the isochrone come from the overlap areas. It seems likely therefore that any two flows which have both their origins and destinations within 500m of one another could be considered as demand-side substitutes by a significant group of customers. Stagecoach submitted that it was not realistic to suggest that users would walk significant distances to other bus stops just to save small amounts of money. However, for many passengers this result does not rely on their walking any further than they do currently, just that they walk in a different direction.

23. For the purposes of analysing competition between operators at the flow level we will therefore assume that any two flows that have both their origins and destinations within 500m of one another are substitutes and therefore may be aggregated together. In order to ensure that our substantive conclusions are not inappropriately sensitive to this assumption, we will apply a sensitivity test to the results.

[11]Stagecoach told us that in the east of the town, there were few routes which were close enough to compete with one another; whereas in the west of the town, the hilly topography meant that walking between stops was likely to be unattractive, and the viable walking distance would tend to be smaller. Overall Stagecoach considered that fewer than ten flows were likely to be able to compete in this way.

The role of supply-side factors

24. According to Stagecoach, supply-side factors would tend to point towards somewhat wider markets. Stagecoach told us that because buses were themselves mobile, this meant that bus capacity could be shifted from one route to an alternative route relatively easily and at short notice so long as there was sufficient depot capacity to enable the buses to be laid up overnight, serviced and supported and to provide rest facilities for the drivers. For this reason, Stagecoach submitted that supply-side substitution would take place around depots: in particular, the costs of 'dead runs' from the depot to the end route would restrict supply-side substitution. To support its view, Stagecoach cited *Chester City Transport v Arriva*[12] in which it told us it was found that supply-side substitution on the basis of which depots could economically supply Chester was a relevant market for competition purposes.

25. Stagecoach also told us that the precise location in Eastbourne that would have to be reached from a depot would depend upon the individual route being operated: in general, for a route beginning operations early in the morning, it would need to reach the end point of the route, which in the case of arterial routes might be the end point furthest from Eastbourne town centre. It also claimed that the locations from which one could economically operate services in Eastbourne included at least the district of Eastbourne, and the towns of Hailsham, Stone Cross, Polegate, Pevensey and Pevensey Bay within Wealden District. Stagecoach raised the possibility that other towns in Sussex, including Brighton and Hove, might also fall in the relevant market, but did not reach a firm conclusion on the precise distance from which it would be economical to serve Eastbourne.

26. Go-Ahead agreed that any operator with a depot (or suitable facilities) within a reasonable drive-time from the flow in question could supply services on that flow, but told us that it believed the market nevertheless consisted of point-to-point flows.

27. We agree that bus companies which have depot facilities with spare capacity sufficiently close to Eastbourne to serve the Eastbourne area should in principle be able to amend bus capacity across most, if not all, flows at relatively short notice to take advantage of profitable opportunities. As discussed in paragraph 34 of Appendix J, running a 'portfolio' of routes in an area from a depot with spare capacity provides incumbent operators with knowledge of the area, brand awareness to passengers and flexibility to add to or to change their services at relatively short notice. In other words, these bus companies should be able to provide a competitive constraint on one another's flows by virtue of their ability easily to amend their route network.

28. We note that, excluding the merging parties, none of the operators we contacted told us that they considered it viable to start or expand the provision of commercial bus services in the Eastbourne area in response to a SSNIP. In particular, we do not consider that Brighton & Hove and Stagecoach, which operate inter-urban services that terminate in Eastbourne, could exercise a significant pre-merger supply-side constraint because their depots are too far away for them to run extra services into Eastbourne in response to a SSNIP: although they may have been able to undertake a small amount of route reconfiguration at the margin, this was unlikely to provide a meaningful constraint.

29. In evaluating the impact of the merger, we note that the competitive conditions relevant to the assessment of the elimination of head-to-head competition between the parties are similar or identical on the great majority of flows in the Eastbourne area.

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[12] *Chester City Council & Anor v Arriva Plc & Ors* (2007).

Therefore, in order to conduct this analysis, we consider that it is appropriate to aggregate these flows together, while noting that in some cases there will be additional competition, for example because of the presence of third-party transport operators on specific flows.

30. As noted above, it is also appropriate to widen the market because of the potential to substitute or easily increase supply on different flows.

31. For these reasons, we consider it appropriate to define a market for the provision of bus services that encompasses the entire Eastbourne area. The focus of our competitive effects analysis will be on evaluating the impact of the mergers on both *(a)* head-to-head competition between the parties (resulting from demand-side substitutability on overlap flows) and *(b)* potential competition between the parties (resulting from supply-side considerations across flows in the Eastbourne area).

3. Constraints from other forms of transport

32. Next we consider whether any other forms of transport should be included in the market we have identified in paragraph 31. Stagecoach submitted that the relevant product market would have to take into account the geographic market that was adopted, for example in relation to the six flows on which rail was an alternative.[13] Stagecoach argued that there would be competition between bus and rail as a result of demand-side substitution by passengers.

33. We accept Stagecoach's view that for some forms of transport the degree of substitutability may vary by flow. For example, rail is clearly only an alternative on some flows, but it may also be the case that on certain journeys it may be more viable to walk than on others and on certain journeys more attractive to take the car than on others.

34. Stagecoach told us that passengers chose between a wide range of options when making journeys. Depending upon the individual passenger or group of passengers and the journey which that passenger wished to make, Stagecoach told us that car, taxis, cycling, walking and rail services could all be potential substitutes for bus services in and around Eastbourne, particularly in the medium to long run when available choices would be wider. This, it submitted, was because, if bus travel were to become more expensive, or of a lower quality, people might purchase bicycles or cars or change their travel patterns. It conceded that some of these options might take too long to be included within a market definition based on the sustainability of prices over a one- to two-year period, but some options were available within the time period.[14]

35. In terms of a formal market definition, Stagecoach told us that the relevant market from a demand-side perspective was therefore at least as wide as an 'all public transport' market on the flows where these options were available. On shorter flows, it argued that walking and cycling might also be sufficiently viable options. Stagecoach also submitted that car travel was an important competitive constraint and that for some trips, taxi would also be, particularly where a group of people were travelling over modest distances.

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[13]Eastbourne Town Centre–Pevensey Bay, Eastbourne Town Centre–Hampden Park and Eastbourne–Polegate (and vice versa).

[14]We consider the SSNIP test on the basis of short-run responses. The CC's Merger Guidelines say: 'This price rise is assumed to last for the foreseeable future and the CC will typically consider the extent of the response which is likely to occur within a year of the price rise (although the exact time period will depend on the nature of the market considered)'. *Merger References: Competition Commission Guidelines, CC2*, paragraph 2.7.

36. In support of its view, Stagecoach submitted the results of a passenger survey (Stagecoach survey) commissioned by Oxera Consulting (Oxera) on its behalf and undertaken by Accent Market Research (Accent). According to Stagecoach, the results demonstrated that other modes of transport imposed constraints on bus pricing. Stagecoach also said that whether or not the survey supported extending the market beyond bus usage depended upon the assumption adopted for the group of individuals who stated that they would reduce bus use to some extent in favour of other modes. However, Stagecoach argued that, under most of the scenarios presented, the survey results supported widening the market to include either walking (if the data was weighted to reflect the mix of peak and off-peak travel) or car if the results were not weighted—see paragraph 60. We discuss the Stagecoach survey in more detail below, in the context of elasticities of demand. Before doing so, we provide a summary of the other evidence we have received on constraints from public and private transport.

Public transport

37. In relation to public transport, Go-Ahead and Arriva told us that bus operators faced competition from public transport, eg rail and taxi. Renown also told us that the relevant market should include rail as well as bus services. Renown said that Southern was a major provider of public transport between Polegate, Hampden Park and Eastbourne, having a significant time advantage between these points.

38. In support of its view that rail was a competitive constraint, Stagecoach cited the following:

(a) CC precedent, namely First Group/ScotRail,[15] which found rail and bus to be substitutes. Stagecoach told us that it was aware that location-specific factors needed to be taken into account, but did not provide evidence in relation to Eastbourne.

(b) Information on the frequency, journey time and price of the rail alternatives on the Eastbourne–Hampden Park, Eastbourne–Polegate and Eastbourne–Pevensey Bay/Westham flows as at April 2009. Stagecoach submitted that competition on the Pevensey flow from competing subsidized rail services had resulted in limited opportunities for the development of bus services whilst rail services from Hampden Park and Polegate provided stiff competition for bus services with cheap fares and quick journey times (see Table 2).

TABLE 2 **Frequency, cost and journey time of rail services on specific flows**

Route	*Peak-time frequency per hour*	*Cost* *Single fare £*	*Return fare £*	*Journey duration (minutes)*
Eastbourne–Hampden Park	4	2.20	2.70	4
Eastbourne–Polegate	4	2.90	3.30	8
Eastbourne–Pevensey Bay	2	2.90	3.30	11

Source: Stagecoach, Southern website.

39. The equivalent data for buses active on these flows as at April 2009 is provided in Table 3. Whilst the individual bus services are less frequent than the comparable rail service, collectively, buses offer a similar frequency. It is clear that single fares are

[15]See *FirstGroup plc and the Scottish Passenger Rail franchise* (June 2004).

generally lower on the bus, but that return fares are more comparable. The journey time is always at least twice as long on the bus as on the train.

TABLE 3 **Frequency, cost and journey time of bus services on rail flows**

	Peak time frequency (minutes)	*Cost*		*Journey duration (minutes)*
		Single fare £	*Return fare £*	
Eastbourne–Hampden Park				
Stagecoach (Loop)	15	1.80	2.70	20
Eastbourne–Polegate				
EBL (51)	30	1.80	2.70	20
EBL (52)	60	1.80	2.70	20
EBL (54)	120	1.80	2.70	20
EBL (56)	N/A	1.80	2.70	30
Stagecoach (98)	60	1.80	2.70	20
Renown Coaches (126)*	120	N/A	N/A	30
Renown Coaches (143)*	2 or 3 trips	N/A	N/A	20
Eastbourne–Pevensey Bay				
EBL (10)	60	1.80	2.70	45
Stagecoach (99)	30	1.40	2.50	20

Source: Stagecoach.

*Tendered service.
Note: N/A = data not supplied.

40. According to Southern (which operates the train franchise on these flows), rail fares were generally more expensive than most off-peak and weekly bus fares in the Eastbourne area so passengers were unlikely in general to substitute from local bus services to rail services if the price of bus services increased by 5 to 10 per cent. However, it told us that, where bus users lived near to a railway station, there might be some transfer depending on local advertising and fare structures. Southern also said that there was probably direct competition with bus services between Eastbourne–Hampden Park and Pevensey/Westham, particularly where people lived relatively close to a railway station. In this regard it said that:

(a) many customers who had special needs or travelled with pushchairs etc were put off travelling by bus as many vehicles did not have the facility to carry disability scooters, prams etc; and

(b) Southern had developed a fare that it was currently trialling in the Eastbourne area that gave concessionaries a 50 per cent reduction in off-peak travel.

41. In relation to taxi, Stagecoach told us that there was a vibrant taxi facility in Eastbourne which was particularly competitive for group travel at all times, but especially at certain times of the day. According to Stagecoach, there were nine taxi ranks in Eastbourne[16] which were conveniently situated for different parts of town and the taxi rank at Eastbourne railway station was closer to the platforms than the bus terminus.

42. Stagecoach has not provided us with any examples of coach services that operate on overlap flows in the Eastbourne area.

[16]Eastbourne railway station, Ashford Road, Old Orchard Road, Hyde Gardens, Bolton Road, Langney Road, Susans Road, Eastbourne Pier and Church Street (opposite Waitrose).

Private transport

43. In relation to private transport, First Group, Go-Ahead and Arriva all told us that the private car was the main competitive constraint on bus operators. To support this statement, Arriva cited the results of its latest annual survey which indicated that 46 per cent of respondents could have made their journey by car. However, Cuckmere Community Bus told us that changes in price, quality or frequency could lead to a switch to alternate transport modes (especially rail where available, cycling or walking), but that the introduction of parking charges in Eastbourne last year, as well as peak-hour congestion, made a return to car commuting less likely in its view.

44. In support of its argument that transport by car was a competitive constraint, Stagecoach told us that attracting travellers away from their cars and into taking buses instead ('modal shift') was central to its strategy and that this 'long-term' constraint could have an impact on 'short-term' pricing. Stagecoach has also claimed that there was some indicative evidence of customers being willing to substitute between car and bus. It told us that:

(a) bus patronage generally had declined over the past 50 years due to increased car ownership;

(b) during the fuel protests in September 2000 bus use increased by up to 30 per cent in some places;

(c) during the period of high fuel prices last summer Stagecoach's primary advertising efforts were focused on car drivers;[17]

(d) government and local authority activity encouraged modal shift, for example the Huntingdon–Cambridge guided bus way was funded on the specific pretext that it would reduce traffic pressure on the A14; and

(e) district councils claimed a link between rising concessionary bus use and falling car park revenues.

45. Each of the examples Stagecoach has provided relates to market developments that are quite different from what we have in mind when we pose the hypothetical monopolist question (whether we frame this in terms of price and/or service quality). For example, substitution patterns under circumstances in which it is not possible to drive one's car because of lack of fuel availability (paragraph 44*(b))* or in response to substantial quality improvements (paragraph 44*(d)*) or in response to bus fares falling to zero (paragraph 44*(e)*) are likely to be rather different from the substitution patterns we would observe in response to a small but significant non-transitory increase in price or worsening in service quality or a combination of these two factors. Nor is this position negated by Stagecoach's long-term strategy; ultimately long-term aspirations to grow the market do not provide the same competitive constraint as the possibility of an imminent reduction in revenue if Stagecoach's offer were to weaken relative to other bus operators.

46. Stagecoach has also provided us with the following Eastbourne-specific information in relation to car usage:

[17] It also told us that prior to this Stagecoach ran a national television advertising campaign promoting Megarider tickets as the best way to access the bus and extolling the virtues of style and reliability often associated with motor car advertising. Stagecoach told us that it would not have spent money on a marketing campaign aimed at car drivers unless it believed that significant modal shift was possible.

(a) Car ownership in Eastbourne is fairly typical for a town of its size with a slightly lower number of cars per household than more rural areas (but slightly more than the lower-income urban area of Hastings).

(b) 6 per cent of commuters travel to work by bus compared with 62 per cent who travel by car or van (13.5 per cent travel on foot and 3.5 per cent cycle). Bus usage for this purpose is higher than the East Sussex and South-East averages (but slightly lower than the Great Britain average) whilst car/van usage is lower (and around the same as the Great Britain average).

(c) There are 2,753 off-street parking spaces and a large number of controlled on-street parking spaces in Eastbourne which start at around £1.60 per hour. There is also ample provision for (often free) parking at other key sites around the area.

47. All these statistics tell us something about the alternatives available to people living in the Eastbourne area. As they stand, however, they do not tell us very much about the alternatives available to bus users. Nor do they tell us anything about the willingness of bus users to substitute to car in the event of a small but significant non-transitory increase in bus prices or worsening in service quality or a combination of these factors. However, estimates of the own-price elasticity for bus (and, if available, non-price elasticities) can be informative on this issue.

Evidence on competitive constraints from elasticity estimates

48. There is an extensive literature on demand elasticities for different modes of transport used for point-to-point journeys. Table 4 lists the various elasticity estimates (divided into price and non-price elasticities) that we have sourced in relation to the bus industry.

TABLE 4 **Summary of elasticity estimates relating to bus services**

Elasticity type	*Elasticity estimate*	*Source*
Own-price elasticities		
Own-price elasticity (own mode*) in the UK in the short run (1–2 years)	–0.46	*The demand for public transport: A practical guide, 2004*
Own-price elasticity (own mode) in the UK in the long run (12–15 years)	–0.86	*The demand for public transport: A practical guide, 2004*
Own-price elasticity (own mode) in the UK in the medium run (5–7 years)	–0.61	*The demand for public transport: A practical guide, 2004*
Own-price elasticity (own mode) in the UK in the short run (1–2 years)—outside London	–0.47	*The demand for public transport: A practical guide, 2004*
Own-price elasticity—after 1990	–0.46	*Review of fares elasticities*, Wardman and Shires, 2003
Own-price elasticity	–0.36 (short run) –0.70 (long run)	OXERA: *Literature Review of Elasticities, 2004*
Own-price elasticity in the short run	–0.30 (peak) –0.40 (off-peak)	OXERA: *Literature Review of Elasticities, 2004*
Own-price elasticity in East Sussex (estimate from unconstrained, variable fare elasticity model)	–1.19	*Demand for local bus services in England*, Dargay and Hanly, 2002
Own-price elasticity in the short run (estimates from unconstrained, variable fare elasticity model)—average across counties	–0.13 (low fare) –0.79 (high fare)	*Demand for local bus services in England*, Dargay and Hanly, 2002
Own-price elasticity in the long run (estimates from unconstrained, variable fare elasticity model)—average across counties	–0.23 (low fare) –1.35 (high fare)	*Demand for local bus services in England*, Dargay and Hanly, 2002
Own-price elasticity in East Sussex in the short run (estimate from unrestricted, constant elasticity model)	–0.79	*Using existing stated preference data to analyse bus preferences*, Wardman, 2000
Own-price elasticity in East Sussex in the long run (estimate from unrestricted, constant elasticity model)	–1.52	*Using existing stated preference data to analyse bus preferences*, Wardman, 2000
Non-price elasticities		
Elasticity with respect to service intervals (vehicle km) in the short run	–0.38	*The demand for public transport: A practical guide, 2004*
Elasticity with respect to service intervals (vehicle km) in the long run	–0.66	*The demand for public transport: A practical guide, 2004*
Elasticites with respect to wait time	–0.39 to –1.17 (depending on trip type)	*The demand for public transport: A practical guide, 2004*
Generalized cost elasticities	–0.4 to –1.7 (depending on trip type and income)	*The demand for public transport: A practical guide, 2004*
Elasticity with respect to in vehicle time	–0.38 (leisure) –0.43 (commuter) –1.01 (business)	*The demand for public transport: A practical guide, 2004*
Elasticity with respect to journey time	–0.66	*Oxera Consumer survey analysis, 2004*
Elasticity with respect to headway between buses	–0.25	*Oxera Consumer survey analysis, 2004*
Elasticity with respect to access and egress time	–0.77	*Oxera Consumer survey analysis, 2004*

Source: Various studies as reported in the table.

*The 'own-mode' elasticity (as opposed to the 'conditional elasticity') is that estimated when fares for one mode change without changes in those of other public transport modes (*The demand for public transport: A practical guide*, 2004, paragraph 5.3).

49. Most estimates indicate that the demand for bus services is inelastic with respect to price (ie the own-price elasticity of demand exceeds –1). The most elastic estimate is –1.52 and this is a long-run elasticity. This is broadly consistent with what one major operator told us, [✂], which said that its experience of the own-price elasticity was not on the whole different from the data the CC had reviewed in previous inquiries into bus mergers, namely that the short- to medium-term elasticity was in the region of –0.4 to –0.6, tending towards –1.0 or more in the medium to long term. However, it also said that the generalization did not apply everywhere and that in some areas the short-term own-price elasticity had tended towards –1.0 where demands upon income were tighter.

50. Most estimates also indicate that the demand for bus services is generally inelastic with respect to non-price factors. The elasticity of demand with respect to the generalized cost of a bus journey (which generally seeks to include all of the factors that contribute to the 'cost' of a journey including fares, travel time, waiting time etc) has been estimated as between –0.4 and –1.7, depending on the trip type and income. Elasticities with respect to wait and journey time are at the most –1.17.

51. Stagecoach accepted that several of the elasticity estimates (for example, the demand for public transport (DFPT) study) implied that price increases would be profitable in both the short and long run, ie that rail, car and other forms of transport were not a relevant competitive constraint to be included in the market.

52. However, Stagecoach also said that:

(a) This is the case at the level of the bus industry on a national basis; consequently this is independent of any mergers. As such, these estimates of elasticity of demand do not appear to be consistent with profit-maximizing behaviour by bus operators.

(b) These estimates are largely outdated. In particular, the estimates in many studies are based on data from before the privatization of the bus industry; they are derived from data that does not include recent changes in concessionary fares, especially the move to free travel for concessionaries under the national scheme in 2006; and they do not reflect the increase in car ownership that has occurred since they were estimated.

(c) Many of the estimates do not refer specifically to East Sussex but to the UK as a whole. In this regard, Stagecoach also told us that it was interesting that the estimate which referred specifically to East Sussex (from Dargay and Hanly, 2002) was considerably higher, at –1.19, than the average estimate for all English counties. According to Stagecoach, this suggested that demand in East Sussex should be expected to be more elastic than for England as a whole.

53. We do not consider that the points Stagecoach has raised should lead us to discount the elasticity evidence. In relation to the argument in paragraph 52*(a)*, just because there is scope for price increases (due to inelastic demand) at the product level does not mean that there is scope for price rises at the firm level: this depends on the firm-level (or residual) elasticity of demand which is generally more elastic than the former because firms face competition from other firms.

54. In relation to paragraph 52*(b)*, we consider that these studies represent the best and most recent analysis available in the literature. In relation to the concessionary scheme, it seems likely that the introduction of the national concessionary scheme would lead to a lower price elasticity, not higher (because passengers who might have been previously somewhat price sensitive are now not price sensitive at all): the

impact on pricing will depend upon the administration of the concessionary scheme (we discuss this in more detail below). In relation to the increase in car ownership, given that the price elasticity estimates are generally well above –1 (or below 1 in absolute terms), any impact upon the substitution patterns of bus users (as distinct from the impact upon the size and identity of the bus user population) of increasing car ownership would have to be large to undermine the conclusion that a SSNIP would be profitable, and this seems quite unlikely.

55. In relation to paragraph 52*(c)*, we note that we are primarily interested in the behaviour of bus passengers in the Eastbourne area. The observations made in paragraph *46(b)* indicate that bus usage in Eastbourne is higher than the East Sussex average (but slightly lower than the Great Britain average) and car/van usage is lower (and around the same as the Great Britain average). Consequently, it is not clear that an elasticity estimate for East Sussex is a better proxy for the Eastbourne area than one for Great Britain. The Wardman (2000) short-run elasticity estimate for East Sussex still indicates an inelastic price response which is not notably different from estimates for Great Britain.

56. In any case, Stagecoach argued that its survey results should be accorded greater weight than any of these estimates because they were both up to date and directly relevant to Eastbourne.

The Stagecoach survey

57. As noted above, Stagecoach commissioned a survey to investigate the sensitivity of passengers in the Eastbourne area to price and frequency changes. The fieldwork, which took the form of face-to-face interviews on board several of the more frequent and heavily-used buses in Eastbourne, was carried out by Accent between Friday 19 June and Wednesday 24 June 2009. Respondents were asked a series of questions including: the reason for their journey, how often they made the trip using the bus, what ticket they were travelling on, whether they owned a car or a motorbike and what other modes of transport they would consider using to make their journey. Respondents were also asked to indicate how they would respond to (i) a 10 per cent increase in fares and (ii) a reduction in frequency equivalent to one bus per hour.

58. These results were passed to Oxera which used them to derive estimates of the 'actual loss' which formed the basis of two distinct critical loss analyses:

(a) a 'basic' critical loss analysis which sought to establish whether a 10 per cent price increase would be profitable; and

(b) an 'extended' critical loss analysis which sought to establish whether a 10 per cent price increase coupled with a reduction in frequency of one bus per hour would be profitable.

In what follows, we focus upon the 'basic' critical loss analysis: the scenarios proposed under the 'extended' critical loss exceed by some way the price and/or frequency changes that are relevant under the hypothetical monopolist test.

59. Table 5 summarizes the results that Stagecoach obtained for the actual loss under different assumptions relating to:

(a) Interpretation of responses: a non-trivial proportion of passengers gave a response to the SSNIP question which was categorized as 'generally continue to use bus, more often use other modes'. Stagecoach told us that the proportion of demand lost from individuals in this group was unspecified, so it adopted a range

of assumptions to derive the 'actual' loss: the base case assumed that passengers in this group would reduce their demand by 50 per cent in response to a SSNIP and sensitivities were presented for 25 per cent and 75 per cent.

(b) Weighting of responses: Stagecoach presented us with results that were: unweighted, weighted by respondents' frequency of use (ie the number of bus journeys per week) and weighted by off-peak/peak usage (ie to reflect differences in the true distribution of peak and off-peak travel relative to the survey sample).

TABLE 5 **Actual losses and confidence intervals* (in brackets) implied by Stagecoach survey results under different assumptions relating to interpretation of responses and weighting method**

per cent values

Weighting method	*25% assumption*	*Base case—50% assumption*	*75% assumption*
A. By frequency of use	8.1 (5.1, 11.2)	11.1 (7.4, 14.9)	14.2 (9.5, 18.8)
B. No reweighting	13.0 (8.3, 17.7)	16.3 (11.3, 21.4)	19.7 (13.9 , 25.5)
C. By off-peak/peak	12.7 (8.5, 16.9)†	15.9 (11.1, 20.5)†	19.1 (13.6, 24.6)†

Source: Stagecoach, except for results marked †, which were generated by the CC using data supplied by Stagecoach.

*A confidence interval shows the range that we expect the true estimate to lie within 95 per cent of the time.
†These confidence intervals are based on the average of the standard deviation of the two groups (peak and off-peak).

60. Stagecoach told us that the 'critical loss' we should compare these results to was 10.1 per cent.[18] According to Stagecoach, for nearly all the estimates (the exception being the 25 per cent assumption in the frequency of use weighting), the actual loss exceeded the critical loss and supported the view that the market should be widened beyond buses. In Stagecoach's view, the version reweighted to reflect the undersampling of peak-time passengers (see paragraph 62), however, was arguably the most appropriate to use when deriving results (ie Table 5, C). Stagecoach told us that the survey responses indicated that the market should be widened to include either walking (if the data was weighted) or car (if the data was unweighted).

61. While we recognize that this survey is potentially relevant evidence available on demand substitution patterns in the Eastbourne area, we had a number of concerns about the survey methodology and analysis of the results which meant that we did not consider Stagecoach's interpretation of the survey evidence to be persuasive.[19]

62. First, the survey was fairly small,[20] particularly in relation to the number of peak passengers sampled.[21] A small number of peak passengers were sampled, 24, of whom 9 were morning peak passengers,[22] and, whilst the results were reweighted to make it more representative of the pattern of off-peak and peak travel in Eastbourne, we were concerned that:

[18]This is a break-even critical loss for a 10 per cent price increase on a product (or set of products) with an 89 per cent gross margin.
[19]We note that there can also be a general risk in posing SSNIP-type survey questions in that respondents may not fully understand a hypothetical scenario, may overstate their willingness to respond to incentives, or may deliberately wish to overstate their willingness to react to a price increase in an attempt to deter a possible price increase. These issues necessitate careful survey design and caution when interpreting responses.
[20]One hundred and fifty-six passengers were asked the 'SSNIP' question, of which 24 were travelling during the peak period—9 in the morning peak and 15 in the afternoon peak period.
[21]This is reflected by relatively wide confidence intervals.
[22]We note that, according to data provided by Stagecoach, in Eastbourne there are on average 4,000 peak passengers, of whom 2,000 are morning passengers (this includes adults only). These figures suggest that the survey sample significantly underrepresents the actual population in terms of peak passengers.

(a) because the number of peak passengers that were sampled was small, this raises concerns over the validity of using this group to represent the peak population; and

(b) morning peak passengers might be more likely primarily to constitute regular travellers commuting to work or school compared with the afternoon peak and therefore be less flexible about substituting to other forms of transport.

63. Secondly, the estimate of the actual loss cannot be directly derived from the survey responses, but depends on exogenous assumptions. In particular, of those respondents who said that they would change their behaviour in response to a fare increase, a significant proportion said that they would reduce bus travel by an unspecified amount.[23] The survey provides no basis for assuming whether this reduction would be proportionately small or large. In other words, on the basis of the survey results it is not possible to determine whether Stagecoach's sensitivity analysis represents a credible range of assumptions for the reduction in demand that the behaviour of this group would give rise to. The findings in Stagecoach's sensitivity analysis can be converted into fare elasticity estimates. As a result, we can compare the elasticity estimates derived from Stagecoach's survey with various published estimates of the short-run fare elasticity (see Table 4). The elasticity estimates implied by Stagecoach's work (see Table 5, C) run from –1.27 to –1.91 and these are much higher (in absolute value) than published estimates of the short-run fare elasticity, which are generally around –0.5. This comparison suggests that Stagecoach's survey has found very high elasticities relative to other sources and this raises concerns.

64. Finally, we also had concerns in relation to the assumptions made to derive the critical loss, in particular as regards the concessionary fare scheme and the gross margin used.

65. As regards the concessionary fare scheme, Stagecoach's critical loss approach assumes that the effect of increasing fares is revenue neutral for concessionary travel. Its justification for this was as follows:

(a) it is not clear how great an impact (if any) increasing price would have on concessionary revenues in either the short or medium term;

(b) even if there was an impact upon revenues, it is unclear whether this would feed through into ex-ante pricing decisions, given the lack of certainty in the system; and

(c) therefore the most likely scenario would be that the concessionary fare scheme would not affect the pricing of bus operators and therefore it should be excluded from the critical loss analysis.[24]

66. In our view, Stagecoach's concessionary revenue neutrality assumption[25] represents a 'worst-case' scenario for a bus operator. The operation of the concessionary scheme is detailed in Appendix E. Concessionary reimbursement is dependent on commercial fare rates and the scheme administrator would need to take special action if they had cause not to allow a proportionate increase in reimbursement rates,

[23]The question was categorized as 'generally continue to use bus, more often use other modes'.
[24]We note that these arguments are relevant to consideration of the incentives on operators' pricing decisions in practice rather than for the SSNIP test where a price change is assumed.
[25]The revenue neutrality assumption entails that reimbursement rates are reduced to fully offset fare increases, so that concessionary revenues do not change.

which the administrator told us had never been done. It is therefore possible that no adjustment is made to the scheme to compensate for a 10 per cent fare increase. Under this ‘best-case’ scenario, the actual loss would need to exceed 13.1 per cent for the fare increase to be unprofitable.[26] In our view (see Appendix E), it is very likely that there would be some increase in concessionary revenues if commercial fares were raised, the effect of which is to increase the critical loss hurdle that the actual loss must exceed.

67. As regards the gross margin used, the critical loss calculations assume that the marginal cost of passengers is 13p (based on the reimbursement under the Sussex concessionary travel scheme) which in turn implies a gross margin of 89 per cent. We are not convinced that this is an appropriate proxy for the marginal cost to use for the critical loss purpose and we think that the gross margin implied is likely to be too high. For example, there may be further reductions in costs following a fare increase as smaller buses and/or fewer buses might be required to serve a reduced number of passengers (see Annex 2 to Appendix E, paragraphs 4 and 5), thus making a hypothetical fare increase more profitable. Adjusting more fully for changes in usage, Stagecoach indicated that the marginal cost of each passenger was 93p[27] and the corresponding gross margin was around 21.1 per cent. A margin of 21.1 per cent yields a critical loss of 32.3 per cent under the ‘worst-case’ scenario for the bus operator (ie concessionary revenue neutrality to a fare increase) and 41.8 per cent under the ‘best-case’ scenario for the bus operator (ie no adjustment to the scheme).

68. Figure 1 summarizes all these issues, showing how the profitability of a 10 per cent price increase depends upon the assumptions on: *(a)* the gross margin; *(b)* the reimbursement of concessionary fares; and *(c)* the actual loss and the corresponding fare elasticity. The gross margin is on the x-axis and the critical and actual losses are on the y-axis. The blue line shows how the critical loss varies when margins change, assuming concessionary revenue neutrality (ie the ‘best-case’ scenario). The red dot corresponds to Stagecoach’s critical loss of 10.1 per cent which assumes a gross margin of nearly 90 per cent. The red line shows how the critical loss varies when margins change, assuming no adjustment to the concessionary revenue scheme (ie the ‘worse-case’ scenario). The light blue dot corresponds to the critical loss of 13.1 per cent we calculated using a 90 per cent margin but taking into account the impact on concessionary revenues. On the extreme left of the graph the green and dark blue dots correspond to the critical losses when the gross margin is 20 per cent under the ‘worst-case’ and ‘best-case’ scenarios respectively. The horizontal lines trace the actual loss. We have shown Stagecoach’s actual loss depending on the assumption made about the behaviour of the group who indicated that they would reduce their demand in response to a price increase (sensitivities at 25 per cent, 50 per cent and 75 per cent) as well as the actual loss corresponding to the short-run fare elasticity estimate of 0.5 (in absolute value) sourced from the relevant literature (see paragraph 63). The region above the red and blue lines, which represent the critical losses, is where the actual loss is larger than the critical loss, ie so many passengers cease to use buses that the SSNIP is unprofitable and therefore the market is wider than bus services. This region is indicated by the arrow in the graph. As the figure shows, the actual loss implied by an elasticity estimate of 0.5 (in

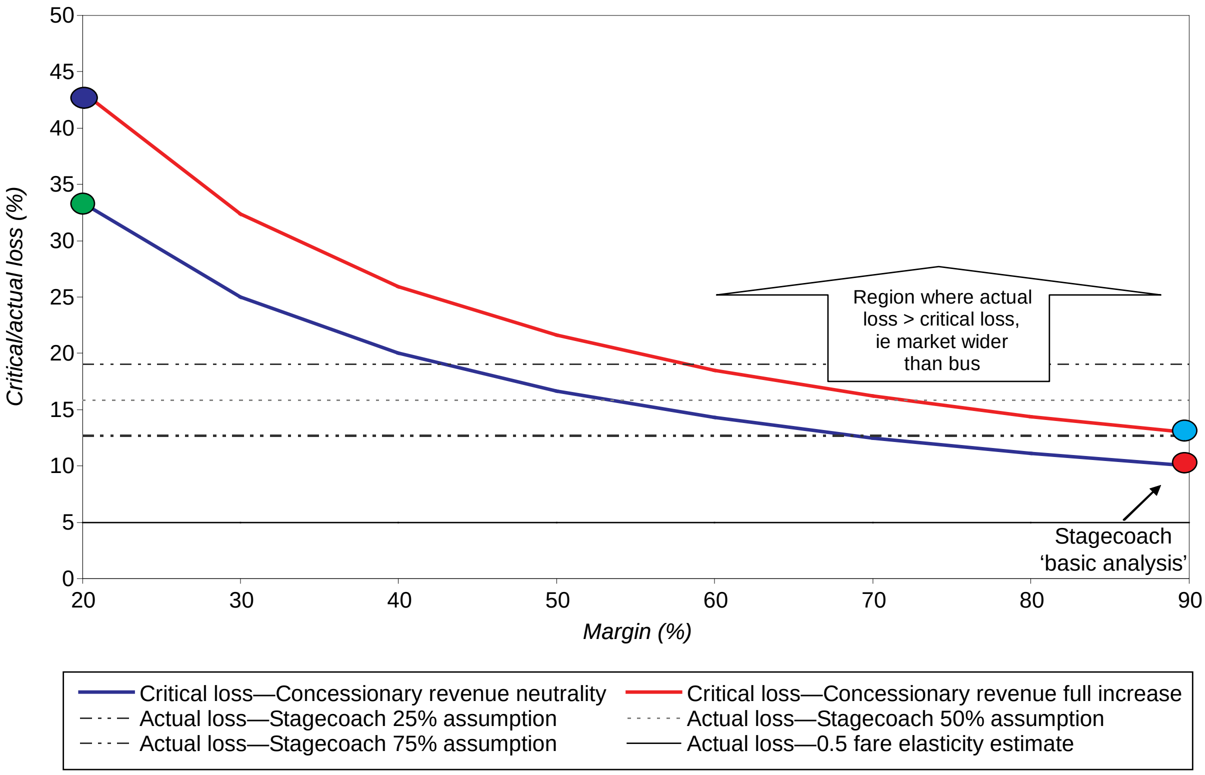
[26] This critical loss estimate is based on a weighted average reimbursement factor of 0.51 (calculated using 0.529 reimbursement rate for urban services and 0.393 reimbursement rate for inter-urban services weighted by passenger numbers in Eastbourne).

[27] This is the incremental cost per passenger when the cost of additional buses is fully taken into account (eg drivers’ payroll, net cost of fuel, PSV licences, PSV insurance, PSV depreciation, PSV maintenance etc). The figure provided is based on EBL 2008 Management Accounts. Stagecoach noted that, if the reduction in demand would entail the usage of smaller buses rather than fewer buses, the frequency would be maintained and the marginal cost would not be as high as 93p, as there would be no savings in driver costs or PSV licences, and there would only be a proportionate saving in fuel, insurance, depreciation and maintenance. As a consequence, the margin would not be as low as 21.1 per cent.

absolute value, this figure is based on published elasticity estimates as explained in paragraph 63) lies below both the blue and red lines for any gross margin, indicating that a 10 per cent price increase would be profitable.[28]

FIGURE 1

Critical loss and actual loss arising from different assumptions



Source: CC analysis using data provided by Stagecoach.

69. Taken together, while we recognize that Stagecoach's survey has directly addressed the issue of customer behaviour in the Eastbourne area, we find that its interpretation of the results delivers a range of possible conclusions dependent on the assumptions made and this means that we cannot consider the survey evidence, on its own, to be persuasive. However, taking into account other evidence and what we consider to be more reasonable assumptions, in particular the most likely fare elasticity, the analysis suggests that the fare rise will be profitable.

[28]Stagecoach pointed out that if fewer buses were required to serve a lower number of passengers, a decrease in the number of buses would imply that there would be a reduction in frequency, which in turn would lead to a lower number of passengers, and so the actual loss would be higher than that estimated on the basis of a fare increase alone. First, we note that, assuming a marginal cost as low as 13p and the gross margin as high as 89 per cent (which was the scenario put forward by Stagecoach in its 'basic' critical loss analysis), the actual loss corresponding to a –0.5 short-run fare elasticity estimate (see paragraph 63) is lower than the critical loss (under any assumption on concessionary revenues), so we would still get a narrow market. Secondly, we note that the hypothetical monopolist test we are discussing is based on the survey evidence of a 10 per cent increase in fares. In the context of the SSNIP test, if there is a cumulative effect of price and service quality changes, we should use a smaller price change such that the combined price and non-price effect is equivalent to a 10 per cent change in the overall attributes. We note that the published estimate of the short-run elasticity with respect to service intervals is approximately at –0.38 (see Table 4), which is lower than the estimated short-run fare elasticity at –0.5. Therefore we would expect that a combined small but significant increase in fares and reduction in frequencies would imply that the actual loss is still lower than the critical loss, which still suggests a narrow market definition.

Conclusions on constraints from other modes of transport

70. In conclusion, the evidence suggests that the competitive constraint provided by other modes of transport is not very strong. Using a range of estimates from various published studies (which we consider to be more persuasive than the results derived from Stagecoach's survey), this shows that the market should be narrowly defined to include bus services only. The only possible exception may be rail where the evidence is somewhat mixed on this point. Although the bus own-price elasticity estimates would appear to be inconsistent with rail in the market, it may well be that these have been estimated using data from areas where rail simply was not an alternative. In any case, we do not need to conclude on whether rail is in the market in Eastbourne since in this inquiry the inclusion of rail would have negligible impact on the competitive impact of the merger.

4. Is it appropriate to segment the market by passenger type?

71. We also note that bus operators can and do price discriminate between different groups of customers by offering different ticket types, for example they can offer 'season' tickets for those who travel regularly and tickets for particular passenger types (eg children). Whilst there are likely to be some differences in price and non-price elasticities across these different groups, we do not think that these differences are sufficient to warrant defining separate markets for different passenger groups. In other words, there is no one group that we think is in an appreciable better or worse position to respond to a small but significant non-transitory worsening of fares, service quality or some combination of those factors.

5. Tendered services

72. Tendered services are those which the local transport authority considers meet a passenger need and which cannot be provided on a viable commercial basis.

73. Stagecoach considered that it was appropriate to define separate markets for commercial, tendered and partly-tendered services. Stagecoach told us that tendered services must be operated in accordance with the relevant conditions of contract and, as a result, the operator of a tendered service had very little discretion as to how it would run the service. Stagecoach also said that tendered services could not compete with overlapping commercial services on the basis of price and/or frequency, as these were set by the local authority for a specific period.

74. In relation to supply-side substitutability, Stagecoach argued that there was no scope for short-term supply-side substitution of buses to or away from tendered services as the service levels were contractual commitments, although buses and drivers used for peak services could be used on commercial services at other times of day at a very low incremental cost.

75. On balance, we consider that it is possible for a tendered service operating on the same flow as a commercial service to exercise a constraint on the commercial service, albeit a small one, for example if its frequency is low. Therefore where a tendered service overlaps with a commercial service, we shall apply the same filters that we do to competing commercial services (in terms of frequency and timetable overlap) to gauge the degree of competitive constraint. However, to understand the impact of the merger on tendered services we need to look at tendered services separately from commercial services, owing to the different pricing mechanisms involved (bidding for contracts rather than posted prices). Therefore, for the purpose

of market definition, we identify a separate market for the right to operate tendered services.

Counterfactual, profitability of Cavendish and failing firm appraisal

Introduction

1. The purpose of this appendix is to set out our financial analysis, including consideration of the failing firm tests for both EBL and Cavendish and the profitability of Cavendish's continuing operations, which are relevant to our assessment of the counterfactual to the acquisitions of EBL and Cavendish by Stagecoach. Whilst the failing firm test determines whether we could find any compelling evidence to suggest that, absent the acquisitions, either EBL or Cavendish would have exited the market in the short term, this appendix also gives consideration to Cavendish's longer-term operations based on a further detailed assessment of its profitability (see paragraphs 30 to 48).

CC guidelines on the failing firm

2. In accordance with the CC's guidelines[1] on merger inquiries, 'for a firm to be considered a failing firm, the CC will need to be satisfied that: *(a)* the firm is unable to meet its financial obligations in the near future; and that *(b)* the target is unable to restructure itself successfully'.

3. The CC guidelines also state that: 'Whether and to what extent the CC will take the failing firm issue into account will depend on various circumstances. First it will need to consider whether any other persons might have acquired the firm, its businesses or any of its assets or wish to do so.'[2] 'Where the CC considers that one of the firms would fail then the situation in the market without the merger may be similar to that which would result from the merger, and thus the merger itself may not lead to any significant changes in the extent of competition in the market.'[3]

Objectives of our failing firm appraisal

4. Our failing firm appraisal focuses on whether EBL and Cavendish would have remained in the market, for at least the short term, if they were not brought under common ownership by Stagecoach. We focused on whether each operator could be regarded as a failing firm and whether either would have inevitably and imminently exited the market in the absence of these two operators falling under single ownership.

EBL—'failing firm' assessment

EBL—criterion 1: ability to meet its financial obligations in the near future

5. EBL generated cumulative operating losses[4] of £0.7 million between 2004 and 2007 (see Appendix B, Table 1). In 2008, the company made a further operating loss of £[✂] million (see Appendix B, Table 2). Against these operating losses, EBL had

[1]*Merger References: Competition Commission Guidelines, CC2*, paragraphs 3.62 and 3.63, June 2003.
[2]*CC2*, paragraph 3.63.
[3]*CC2*, paragraph 3.61.
[4]Excluding an exceptional pension provision of £1.5 million.

total financial liabilities[5] of £1.3 million as at 31 December 2007, of which around £0.5 million fell due within 12 months (see Appendix B, Table 5).

6. Between 2005 and 2007, EBL's cumulative cash flows from operations were about £0.5 million against cumulative debt servicing costs of £2.0 million (see Appendix B, Table 3). EBL was able to meet its financial obligations during this period by raising £0.8 million from asset disposals and £0.3 million from new loans, which were arranged in October 2007 when EBC agreed to release to the bank some of its security under its debenture loan. During 2007, EBL faced cash-flow issues, which were addressed by an emergency loan of £150,000 in April 2007 from one of its executive directors after EBC declined to provide a loan on the basis that EBC 'did not have the power to make a loan or give a guarantee'. The personal loan was repaid when EBL raised new bank loans in October 2007.

7. EBC told us that EBL's overdraft utilization levels were sustained at around £0.4 million, close to its facility limit of £0.5 million. EBL was also in breach for non-payment to EBC, under its tourist coach park and Dotto tourist train contracts and EBC debenture for amounts totalling around £140,000, which from April 2008 EBC did not pursue in order to ease pressure on the company's overdraft facility.

8. In May 2008, EBC was advised that it had grounds to put EBL into administration. It decided to commence a sale process 'in order to get the best sale arrangement and to maintain continuity of bus services to the public'. In June 2008, EBL's auditors indicated to EBL that its audit report would note that the business's future as a going concern would be in doubt if additional funding could not be found by the winter of 2008/09.

9. In the months leading up to EBL's sale process, against a backdrop of sustained operating losses, negative cash flows and net current liabilities, EBL's ability to maintain its capital structure and meet its financial obligations in the near future would have been under considerable pressure unless EBL could secure new financing from its shareholders, debt providers or through further asset sales.

EBL—criterion 2: ability to restructure itself

10. We considered that EBL's ability to increase its overdraft limit/raise new debt facilities would have been constrained by: *(a)* EBC's willingness and ability[6] to release to the bank further security under its debenture; and *(b)* EBL's ability to service its already high levels of debt against a profile of operating losses and negative cash flows. EBC told us that in April 2008, it was informed by EBL that 'the level of the overdraft was critical and the bank would not extend its exposure without some form of security for both the existing overdraft and any extension [of the facility limit]'. EBL may also have had a limited unencumbered asset base (eg as at 31 December 2007, EBL had total liabilities of £1.3 million plus a £0.9 million net pension deficit against tangible assets of £2.6 million), which may have restricted EBL's ability to generate surplus cash through asset disposals.

11. We noted that EBC and Keolis had unsuccessfully attempted to improve EBL's financial performance in the past. Keolis told us that it had limited day-to-day involvement in EBL's operations and informed EBC in October 2007 that it wished to dispose of

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[5]Excluding its net pension deficit of £0.9 million.
[6]EBL's overdraft and loan facilities were already fully secured by the company's tangible assets.

its minority stake in EBL. We also noted the legal restrictions[7] concerning EBC's ability to take direct action in relation to EBL's financial issues.

12. EBL's ability to restructure would have been limited based on the willingness and ability of its shareholders and debt providers to continue to support the business. EBL's stakeholders may have had a number of restructuring alternatives to consider, but we did not consider it necessary to conclude whether any of these was likely, given that EBL did not meet the third 'failing firm' criterion as outlined below.

EBL—criterion 3: availability of a competitive alternative

13. We concluded that it was unlikely that absent its acquisition by Stagecoach, EBL was a failing firm and would have ceased operating bus services altogether given: *(a)* EBC's stated priority to ensure the continuation of bus services in Eastbourne; and *(b)* the intrinsic value of EBL's business/assets as a stand-alone entity, which would provide an acquirer with the infrastructure necessary to operate local bus services within Eastbourne.

14. The only other bid received during EBL's sale process was from Go-Ahead. Go-Ahead told us that its strategy would have been to acquire both Cavendish and EBL and that it would not have proceeded to acquire EBL if it could not also acquire Cavendish. That proposal would in effect give rise to a similar situation to the merger under consideration and would likely fall for competition assessment itself. Any such proposal would not be permitted if it gave rise to competition concerns. It is therefore not relevant or appropriate to consider this as the likely counterfactual, nor is it relevant or appropriate to consider a counterfactual where Renown acquires EBL, since that would also give rise to a similar situation to the merger under consideration. Nevertheless Go-Ahead was the only other company which had submitted an offer for EBL.

15. We did not believe that this necessarily implies that there would be no credible buyer for EBL under any circumstances. Stagecoach's initial offer for EBL attributed value to EBL's business and assets on a stand-alone basis and other bidders may well have come forward under different circumstances. Stagecoach's decision to submit its initial offer did not take into consideration a potential acquisition of Cavendish. Furthermore, a large proportion of the equity value component of Stagecoach's initial offer for EBL was acquisition goodwill, which may suggest that Stagecoach believed there was intrinsic value and potential for profitability in EBL's business on a stand-alone basis over and above the net asset value of the business, eg EBL's assets provided a potential acquirer with the necessary infrastructure for immediate entry into the Eastbourne local bus market.

16. Our assessment that an alternative buyer could have been found for EBL's business that would not result in a similar situation to the merger under consideration or raise competition concerns is based on: *(a)* the intrinsic value to a potential market entrant of EBL's large parking and maintenance depot, vehicle fleet and incumbent market position; *(b)* EBC's priority to keep bus services running; and *(c)* the importance and urgency to both EBL and its shareholders of concluding a sale and their willingness to accept a lower valuation for the business. We therefore concluded that it was more likely that a buyer would be found for EBL than that it would cease to trade altogether.

[7] The Transport Act 1985 resulted in local authorities being obliged to transfer their bus operations to entities operating at arm's length.

17. Under such new ownership, we thought it likely that EBL would be restructured. Whilst we cannot speculate on the extent to which EBL might have been restructured under new ownership nor the options that might be available to its new owner, we believed that there were a number of areas which the restructuring could have addressed, including: *(a)* adopting a more commercial approach to operating bus services resulting from management and organizational change; *(b)* a reconfiguration of EBL's network of routes; *(c)* a more sustainable and efficient capital structure; and *(d)* potential cost savings and synergies.

18. Stagecoach had identified around £[✄] million of annual cost savings for EBL comprising savings on staff costs, procurement and central cost synergies. These cost savings were not contingent upon Stagecoach also acquiring Cavendish but were cost benefits derived from a change in ownership. It is also possible that EBC would have offered to indemnify an alternative buyer from EBL's defined benefit pension funding costs as EBC had done with Stagecoach and Go-Ahead during the sale process.

19. We concluded that a potential acquirer would be likely to see intrinsic value in EBL as a platform for immediate market entry into Eastbourne. In addition, whilst we cannot ascertain precisely the extent to which the above cost savings could also have been achieved by an alternative bidder, we are satisfied that there was some scope within EBL for its costs to have been reduced under a changed ownership structure. We did not find compelling evidence that, absent its acquisition, EBL was likely to exit the market in the short term.

EBL—conclusions on failing firm assessment

20. On this basis, we conclude that EBL could not be regarded as a failing firm and that it was likely to have continued to operate within the Eastbourne market, but most likely under new ownership.

Cavendish—'failing firm' assessment

Cavendish—criterion 1: ability to meet its financial obligations in the near future

21. In our assessment of whether Cavendish could have met its financial obligations in the near future, we considered it appropriate to include Renown's contribution to Cavendish's financials, given that this would be consistent with how its owner intended to operate and fund Cavendish at the time. Cavendish was never operated as a stand-alone business and its arrangements with Renown, where Renown bore many of the maintenance costs and overheads of the business which were already committed, enabled Cavendish to be operated primarily with regard to its direct costs (which included driver, net fuel, tyre, licence and insurance costs). These arrangements had been in place since Cavendish entered the market in 2006. Therefore, we have not treated Cavendish as a stand-alone business in our assessment of each of the three failing firm criteria for Cavendish.

22. Within the context of the failing firm test, our assessment of Cavendish's ability to meet its financial obligations, focused on Cavendish's ability to meet its financial obligations in the short term and whether a failure to meet its short-term financial obligations would have resulted in an inevitable and imminent exit by Cavendish from the market.

23. As we set out below in our profitability analysis of Cavendish in paragraphs 30 to 48, we concluded that Cavendish was likely to have covered its direct costs over the sum of its commercial operations at March 2008, but unlikely to have covered its total costs, including costs that would reasonably be expected for an operator intending to continue operations for the longer term. However, given that the first criterion for the ‘failing firm’ test is primarily concerned with Cavendish’s ability to meet its short-term financial obligations and our analysis showed that Cavendish was able to meet its immediate financial obligations prior to its service uplift in the second half of 2008, we were satisfied that Cavendish did not meet the first ‘failing firm’ criterion based on its level of services at March 2008.

24. However, given that Cavendish was unprofitable in the months leading up to its sale (following its uplift in services in the second half of 2008) and we cannot ascertain in the absence of reliable financial accounts, the materiality of the impact this may have had on Cavendish’s ability to meet its short-term financial obligations, we assess below whether Cavendish could have restructured itself to a level prior to its service uplift.

Cavendish—criterion 2: ability to restructure itself

25. Renown told us that if Cavendish had not been acquired and EBL had been acquired by another operator, Cavendish would have been faced with a wide ‘range of possibilities’. In the absence of its acquisition by Stagecoach, Renown did not have a firm view of what strategy it would have immediately pursued at that point, but stated that whether it would have retrenched or exited the market altogether would have depended upon which operator acquired EBL. Stagecoach stated that had Cavendish not been acquired, Cavendish ‘would, in the short term, have been forced to reduce its services significantly and withdraw unprofitable routes’. Evidence from both Renown and Stagecoach suggests that Cavendish would have been able to restructure itself through reconfiguring its routes and scaling back its operations in the short term to a level that was achieved prior to its uplift in peak services. This would have been possible subject to giving due notice to the Traffic Commissioner. As we highlighted above, we note that the focus of the failing firm test is on the short term and therefore, in this context, our assessment of the second criterion for Cavendish did not need to take into account any longer-term considerations, which are addressed in our analysis of Cavendish’s profitability in paragraphs 30 to 48.

26. In the context of the failing firm test, under a scenario where Cavendish is not sold, we did not find compelling evidence to suggest that Cavendish could not have been restructured or retrenched in the short term, such that Cavendish would be able to return itself to a level of service which was in place prior to its service uplift. It is reasonable therefore to consider it likely that Cavendish’s cost-sharing arrangements with Renown would have continued and that Cavendish could have continued to operate in relation to covering its direct costs for at least the short term. An assessment of whether they would have been likely to choose to continue with this business model in the medium term is addressed in paragraphs 30 to 48.

Cavendish—criterion 3: availability of a competitive alternative

27. As stated above, to the extent that any purchaser might have had a strategy to acquire both Cavendish and EBL, we concluded that it was not relevant or appropriate to consider this as the likely counterfactual. Given that Cavendish’s business model relied on Renown’s facilities, including maintenance, management and back-office support, we thought it unlikely that any third party would find Cavendish an attractive acquisition as a stand-alone entity.

28. Stagecoach did not tell us that Cavendish, had it not been acquired, would have inevitably or imminently exited the market, but said that it was ‘conceivable that Cavendish would have continued to operate independently in the short term’ and that ‘faced with an efficient operator … Cavendish would have reduced services considerably to avoid continuing losses on routes’. Stagecoach also told us that under a scenario where it had only acquired Cavendish, with Go-Ahead acquiring EBL, Stagecoach would have considered competing with Go-Ahead, if it could not sell Cavendish to Go-Ahead, but with a scaled-down Cavendish fleet of around 15 to 20 buses from a base in Eastbourne serving as an outstation to its Hastings depot. See footnote to paragraph 6.12 in the main report.

Cavendish—conclusions on failing firm assessment

29. Based on the above, we concluded that Cavendish could not be regarded as a failing firm and that absent its acquisition by Stagecoach, Cavendish would not have inevitably and imminently exited the market.

Cavendish profitability

30. In the context of our failing firm tests for EBL and Cavendish, both operators could not be regarded as failing firms, and therefore each operator’s immediate exit from the market was not inevitable. However, we also assessed Cavendish’s longer-term prospects given that these would have influenced the choices Cavendish’s management would have had to make, and we give further consideration to Cavendish’s longer-term profitability below.

31. Our counterfactual in the provisional findings adopted March 2008 as a reference point for the degree of competition which was likely to arise between EBL and Cavendish in the absence of the merger. In its response to our provisional findings, Stagecoach argued that when reasonable costs for a sustainable bus operator were taken into account, Cavendish was not operating profitably as at March 2008. Stagecoach stated that ‘without cash generated to replace vehicles, [Cavendish] would not have survived and there was no incentive upon Renown to continue to deploy valuable vehicles in a loss-making business’. Stagecoach added that therefore ‘there was little prospect of the Cavendish business being continued other than as a strategic investment to exploit the downfall of EBL’.

32. When assessing profitability, we consider the extent to which a firm covers its direct and indirect costs. In general, we would consider an operation profitable if it was covering its direct costs in the short term; however, in the medium term an operation would also need to be making a contribution to overheads and providing a return on the capital invested. In the case of Cavendish, since it entered the market in March 2006, Cavendish was operated to ensure that it covered its direct costs (including driver, net fuel, tyre, licence and insurance costs) with maintenance costs and other fixed costs being largely borne by Renown. Whilst vehicle maintenance costs are largely linked to bus output (eg hours of operation), for the purpose of our profitability analysis, we have excluded maintenance costs from direct costs when assessing Cavendish’s short-term profitability given that Cavendish’s maintenance arrangements with Renown had been in place since March 2006 (where Cavendish had shared the maintenance facilities at Renown’s depot without accounting for the full costs of these maintenance activities) and we did not find any evidence to suggest that these arrangements would have changed in the short term. However, we included maintenance costs in the calculation of total costs as part of a wider assessment of Cavendish’s longer-term profitability. Therefore, in our assessment of Cavendish’s longer-term profitability, we took into account maintenance, depreciation

and other overhead costs, but only to the extent that these costs were incremental to Renown, relating specifically to the Cavendish operation (see paragraphs 40 to 44). This is appropriate as we are assessing the profitability of the Cavendish business to Renown where it was not operated as a stand-alone entity.

Analysis of Cavendish's profitability

33. Stagecoach submitted a schedule of Cavendish's commercial routes (excluding tendered services), which assessed Cavendish's profitability as at March 2008 based on comparing Cavendish's commercial revenues per hour, on a route-by-route basis, against Stagecoach's estimates of direct and incremental overhead costs per hour that would be reasonably incurred by Cavendish, if it intended to continue operations in the longer term.

34. We made a number of amendments and adjustments to Stagecoach's profitability analysis (primarily on revenue figures), which Stagecoach has confirmed were appropriate. The resulting table is presented in Table 1.

TABLE 1 **Profitability analysis of Cavendish's commercial routes at March 2008**

Route	*Total revenue £*	*Total hours per month hours*	*Adjusted revenue per hour £*	*Total cost* per hour £*	*Profit per hour £*	*Direct cost per hour £*	*Direct contribution† per hour £*
8/8A	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
9	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
10	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
11	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
18	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
50	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
56	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]
Sub-total	[✂]	[✂]	[✂]	(21.74)	[✂]	(14.91)	[✂]

Source: CC analysis of Stagecoach data.

*Total costs include direct costs plus maintenance and repair costs as well as incremental overhead costs (see Table 2).
†Direct contribution per hour is calculated based on revenue per hour less direct cost per hour.

35. We note the following points and assumptions in relation to the figures presented in Table 1:

(a) In the absence of any accurate or reliable cost data for Cavendish, Stagecoach produced a pro-forma total cost per hour figure (see Table 2) for Cavendish based on an estimate of the overall costs that Stagecoach would expect an average Cavendish bus to incur and then making an assumption about the annual hours of operation.

(b) In March 2008, whilst Cavendish's published timetable for the seven routes in Table 1 had a peak vehicle requirement of 17 buses, Cavendish had a bus fleet of only 12 buses for peak services and 1 for off-peak services (see Appendix C, Table 1). Renown confirmed that Renown buses were used on Cavendish routes to fulfil this shortfall and that revenues arising on Cavendish's routes serviced by Renown buses were included in the Cavendish revenue data set out in Table 1. Concessionary revenues were adjusted to reflect the reimbursement rates applicable at March 2008.

(c) The revenue data underlying the figures in Table 1 were sourced from Cavendish's on-bus ticket machines and presented in a weekly format. There-

fore, March 2008 was defined as the four-week period beginning 24 February 2008 to 22 March 2008.

(d) Stagecoach told us that the figures for Cavendish's total hours of operation during March 2008 for each route were based on Cavendish's published weekday and weekend timetables and a four-week period for March 2008.

(e) Whilst route 22 was a commercial service that was operating in March 2008, this was excluded from Stagecoach's analysis given that route 22 had revenues of only around £[✂].

36. We consider below Cavendish's longer-term profitability after assessing the relevant considerations for Cavendish's revenues and costs.

Revenue considerations

37. In assessing Cavendish's profitability, a single month (ie March 2008) cannot be wholly reflective of the overall financial performance of Cavendish, as revenues in the Eastbourne bus market are affected by seasonality. We therefore considered the period from February 2008 to July 2008 (with each month being defined as a four-week period), a six-month period over which Cavendish's peak vehicle requirement and route frequency were broadly similar to March 2008 levels. We noted that there were only a minor number of changes to the routes' timetables between 4 February 2008 and 14 July 2008. Given the considerable service changes (both in terms of fleet size and frequency) subsequent to 14 July 2008, we did not consider that we were able to use the full 12 months of Cavendish's revenue data available to assess Cavendish's annual revenue seasonality.

38. In order to observe revenue seasonality in the Eastbourne market, we reviewed two years of EBL's monthly local bus revenues, which showed that revenues followed a consistent pattern of seasonality in both 2007 and 2008, with July being a peak month and December being the month where the least revenues are generated. In both years, revenue increased in the period from January to July and then reduced from July to December. The total revenue in the first six months of the year was slightly higher than the second half of the year in both 2007 and 2008 (by 2 and 3 per cent respectively). As this shows that revenues for the second half of the calendar year were likely to be broadly similar to the first half, we therefore considered it reasonable to base our analysis on the available revenue-per-hour figures from February 2008 to July 2008 in our assessment of Cavendish's profitability in paragraphs 45 to 48, as this will be broadly representative of an annual pattern, assuming Cavendish maintained its March 2008 level of services.

39. One small caveat in relation to treating the six four-week periods from February 2008 to July 2008 as representative of a full year's performance is that route [✂] was a new route which Cavendish introduced on [✂]. Route [✂]'s revenue profile for the period from February 2008 to July 2008 appeared to reflect the time taken for the route to mature and 'ramp-up' its revenues. Therefore, calendar year 2008 second half revenues might be expected to be higher for route [✂] than the first half.

Cost considerations

40. Stagecoach derived a pro-forma cost per hour on a 'bottom-up' basis, which is presented in Table 2.

TABLE 2 **Estimate of Cavendish's cost per hour at March 2008**

	£ per hour
Direct costs	
Driver costs	10.97
Net fuel costs	3.07
Tyres, licence, insurance	0.87
	14.91
Operating costs	
Vehicle replacement/repairs	
Vehicle lease/depreciation	2.50
Repairs & maintenance	2.56
Other operating costs	
Depot costs	0.02
Supervisor, cleaning costs	0.88
Timetable, printing, IT	0.88
	6.83
Total cost per hour	21.74

Source: Stagecoach.

41. Stagecoach's analysis of Cavendish's pro-forma cost per hour appears to have been completed on an incremental basis looking only at the extra costs incurred in running the Cavendish services as supervisory and management overhead costs as well as other support functions that were carried out by the Renown business have not been included. As stated above, this is appropriate given that we are assessing the profitability of the Cavendish business to Renown and not Cavendish's stand-alone profitability. In attempting to capture Cavendish's 'ongoing viability and sustainability of the business', Stagecoach has included leasing/depreciation charges, with Stagecoach stating that 'the vehicles would need to be replaced if the Commission seeks to argue that Cavendish could operate as an ongoing business at March 2008 levels'.

42. In our assessment of costs, we examined Stagecoach's analysis of the costs per hour of Cavendish's operations. We looked at each cost item to see whether we thought it was reasonable. We also looked at EBL's costs as a benchmark, although we noted evidence that EBL was not considered to be an efficient operator. When focused on the larger cost items (ie driver wages, fuel costs, annual leasing/depreciation charge and maintenance costs) to the costs per bus for EBL during 2008, the benchmarking analysis suggested that the costs assumed for Cavendish were reasonable. The drivers' costs and maintenance cost items were notably lower for Cavendish than for EBL.

43. Stagecoach's profitability analysis assumed that a total cost per hour of £21.74 was an appropriate measure of total cost per hour across all the routes operated by Cavendish regardless of intensity in terms of operating hours. However, given that Cavendish management did not appear to run the business with a strong degree of certainty over the costs involved at a route level, and given the limited evidence available to improve upon Stagecoach's standard cost assumption, we considered it reasonable and appropriate that a standard cost assumption be used across all of Cavendish's commercial routes.

44. We considered Stagecoach's estimate of Cavendish's total costs of £21.74 per hour including depreciation, maintenance and incremental overhead costs, and £14.91 per hour for direct costs, to be reasonable. If anything, these cost assumptions appeared to be lower in some respects than Cavendish was actually incurring.

Our assessment of profitability

45. Table 1 showed that at March 2008, Cavendish was overall covering its direct costs, but making a loss on all its commercial routes after depreciation, maintenance and incremental overheads were taken into account. On a route level, four routes ([✄]) were not covering their direct costs, although two of these ([✄]) were new or recently altered routes, and made a positive contribution after direct costs in April 2008, which suggests that annually they may have been able to do so.

46. Given that this analysis excluded Cavendish's tendered services, Renown and Cavendish's overall financial performance and position may also need to take account of tendered as well as commercial services. Route 56 was partly tendered for morning and afternoon school journeys (with commercial services operated in between). Renown noted that the tendered income earned on route 56 (this was earned by Renown and not Cavendish) enabled the commercial service to operate at marginal cost. Routes 57 and 58 were also school services and route 10 had a tendered element from the end of March 2008. In addition, Cavendish's services 126 and 143 from Eastbourne to Seaford and Lewes respectively were also tendered (and are now operated by Renown).

47. We calculated the revenue per hour for each of Cavendish's commercial routes (ie excluding all tendered revenues, whether or not those tendered revenues were generated on commercial routes with a tendered service element) based on the available data from February 2008 to July 2008 (based on an assumption of a four-week period for each month). The six months following February 2008 showed a similar picture, with all routes except [✄] and [✄] making a positive contribution after direct costs. Only route [✄] was close to breaking even on a total cost basis (ie taking into account direct, maintenance and incremental overhead costs).

48. Our further consideration of Cavendish's profitability has therefore shown that whilst Cavendish was covering its direct costs, it was most likely that it was making losses when depreciation, maintenance and incremental overhead costs were taken into account.

Competition on overlap flows in the Eastbourne area

1. This appendix sets out the methodology we have used to quantify the extent of head-to-head competition between different competitors on flows in the Eastbourne area and our results.

2. Our analysis relates to operations at March 2008. Renown told us that Cavendish's operations immediately prior to the merger were not covering its direct costs (which included driver, fuel (net of fuel duty rebate), tyre, licence and insurance costs). We have therefore used March 2008 as a more relevant and sustainable benchmark, in that Cavendish was at least covering its direct costs at that point, although we acknowledge that this will understate the degree of overlap between EBL and Cavendish relative to the immediate pre-merger situation.

3. In addition to looking at the March 2008 operations, we have also looked at a far more limited Cavendish operation. As explained in Appendix H, only one route, based on March 2008 data, was near to covering its total costs (including direct costs plus maintenance, depreciation and leasing, as well as incremental overhead costs). We have therefore looked at the degree of overlap that would arise if Cavendish only were to operate this route.

4. As we discuss in more detail below, the focus of our analysis is primarily on the degree of overlap faced by EBL; data limitations prevented us from being able to conduct our overlap analysis for Cavendish. However, Stagecoach provided us with a rough estimate of its own for the proportion of Cavendish revenue derived from flows on which EBL was active (see paragraph 12).

Description of the data

5. Stagecoach provided us with detailed data about the services active on major 'overlap' flows in the Eastbourne area where:

   (a) A 'flow' was defined as any direct connection between two specified fare stages.

   (b) An 'overlap flow' was defined as a flow on which any two companies operated a service that stopped at stops coinciding with the origin and destination fare stages that constituted the flow.[1]

   (c) 'Major overlap flows' were defined as the most important in terms of revenues and together accounted for approximately 90 per cent of revenue on overlap flows for each of Stagecoach, EBL and Cavendish.

   (d) The 'Eastbourne area' was defined as the areas where there was, or areas near, any overlap between services offered by Stagecoach, EBL and Cavendish, including Eastbourne and Hailsham.

6. Stagecoach also provided us with data based on a definition that classified an 'overlap flow' as a flow on which any two companies operated a service that stopped at

[1] To qualify as an 'overlap flow', it was not necessary for the services to take the same route, just that the services connected the specified fare stages. For the purposes of this analysis, train services were included as well as bus services.

stops lying within 500m walking distance from the origin and destination fare stages that constituted the flow (see paragraph 13).

7. The detailed flow level data included (where available): number of passengers and revenue from each service; the first and last bus times; and the average on-peak and off-peak frequency of each service on the flow for weekdays and weekend days.

8. Stagecoach also provided the following information for each of EBL, Cavendish and Stagecoach: total revenue from all services within the Eastbourne area; and total revenue from outside the Eastbourne area (from services that started or finished within the Eastbourne area).

9. The data contained a number of gaps and inconsistencies. Additionally Stagecoach told us that the flow level information derived from ticket sales could only be taken as a guide because with flat fares there is no requirement for the passenger or driver to specify the destination. Consequently the record of journeys from ticket sales is not comprehensive and some adjustments and estimates had to be made. For both of these reasons, the estimates we have produced should be seen as approximate.

CC analysis

10. To quantify the degree of head-to-head competition involving the parties, we sought to analyse the degree to which each of the merging parties derived revenue from flows on which there was also an alternate provider present.

11. In practice, Stagecoach derives just 16 per cent of the revenues on its inter-urban routes from flows in the Eastbourne area: for this reason, we do not report the data quantifying the degree to which Stagecoach competes with other providers on these flows.

TABLE 1 **Percentage of revenues derived from flows in the Eastbourne area: EBL, Cavendish and Stagecoach, 24 February to 22 March 2008**

	EBL	*Cavendish*	*Stagecoach*
Revenue from flows in the Eastbourne area (£)	[✂]	[✂]*	[✂]
Total revenue from these routes (£)	[✂]	[✂]	[✂]
Revenues from flows in the Eastbourne area/total revenue (%)	88	100	16

Source: CC analysis of data provided by Stagecoach.

*This figure is based on Stagecoach's assumption of £0.81 per concessionary ticket. We note that when calculating Cavendish's March 2008 revenues in Appendix H (Table 1), we adopted Renown's assumption of £0.70 per concessionary ticket.

12. As noted, Stagecoach was unable to provide us with detailed flow level data for Cavendish. However, Stagecoach provided us with a rough estimate of the proportion of revenue that Cavendish earned from flows on which it was in competition with EBL (see Table 2). This indicated that, whilst there was some variation across routes, overall Cavendish derived approximately 83 per cent of its revenue from flows on which it competed with EBL. We do not know what proportion of this revenue came from flows on which other firms were active (eg rail or Brighton & Hove), but Stagecoach told us that this was likely to be very small.

TABLE 2 **Estimated proportion of Cavendish's revenues in the Eastbourne area derived from flows on which it competed with EBL by service, 24 February to 22 March 2008**

Route	*Revenue from overlap with EBL %*
8	98
9	76
10	94
11	52
18	91
50	93
56	93
Total	83

Source: Stagecoach.

13. In paragraphs 5.9 and 5.10 of the main body of the report we concluded that, for the purposes of analysing competition between operators at the flow level, it was appropriate to aggregate flows that have both their origins and destinations within 500m of one another, as these are potential substitutes for passengers.

14. It is also conceivable that demand-side substitution between services on a given flow (or cluster of flows) could vary depending upon:

(a) the degree of timetable overlap between the services; and

(b) the relative frequency of services.

15. In relation to these points, Stagecoach said that timetable overlap between two services was an important feature of the degree of demand-side substitutability, for example a daytime-only service and an evening-only service were unlikely to place competitive constraints on one another.

16. However, Stagecoach did not believe that frequency necessarily precluded substitution from taking place between two different bus services. It said that, in principle, changes in the relative prices of two services with somewhat different frequencies and journey times might still generate substitution between them, as customers traded off the various competitive dimensions against one another. In our view, however, services that run to appreciably different frequencies are less likely to pose an effective competitive constraint on one another because:

(a) if the service frequency of one operator is much lower than another, there will be fewer instances of competition for passengers waiting at bus stops; and

(b) if the service frequency of one operator is much lower than another, there may even be less competition for passengers who seek to catch a timetabled service as they may be less likely to plan to use an infrequent service.

17. It is difficult to form a view on what level of timetable overlap and frequency overlap is necessary to conclude that two services are effective competitors. In the absence of any Eastbourne-specific quantitative evidence on this point, where relevant, we have adopted the 'filters' applied in previous inquiries (see FirstGroup/ScotRail and Arriva/Sovereign), and tested the sensitivity of our results to these assumptions. In our view, the relevant 'filters' are:

(a) two services are considered to be effective competitors if there is at least a partial overlap between their timetables;[2] and

(b) on 'frequent' services (ie services running every 10 minutes or less), for a competitor to be effective it would have to run with a frequency of no more than 10 minutes greater than the incumbent. On 'less frequent' services, competitors running with frequencies no lower than half are considered effective.[3]

18. It is often the case that, in the Eastbourne area, the same operator runs *multiple* services on the same flow. We have therefore implemented these two 'filters' as follows:

(a) we have excluded any bus service which stops before the first of the EBL's services starts *or* starts after the last of the EBL's services stops; and

(b) in relation to frequency:[4]

(i) if the *combined frequency* of all EBL's services on the flow was higher than one bus every 10 minutes, then we have excluded any alternative provider from that flow if its *combined frequency* was lower than the equivalent of EBL's plus 10 minutes, eg if EBL's combined frequency was one bus every 5 minutes, then we would exclude an alternative provider on that flow if its combined frequency was lower than one bus every 15 minutes; and

(ii) if the combined frequency of all EBL's services was lower than one bus every 10 minutes, then we have excluded any alternative provider from that flow if its combined frequency was lower than *half* that of Eastbourne Buses, eg if EBL's combined frequency was one bus every 20 minutes, then we would exclude an alternative provider on that flow if its combined frequency was lower than one bus every 40 minutes.

19. Table 3 reports the number of flows and total revenue earned by EBL on overlapping flows split by overlap type, on the basis of the 500m radius definition and the application of the filters discussed above for the period 24 February to 22 March 2008. As discussed in paragraph 2, we used this period as a point of comparison reflecting Cavendish's operations which were covering its direct costs before its large and unprofitable service uplift. In this period, where EBL faced head-to-head competition, it was most likely to be from Cavendish alone.

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[2]See *FirstGroup plc and the Scottish Passenger Rail franchise*, Annex G, paragraphs 22–23 (June 2004).
[3]See *FirstGroup plc and the Scottish Passenger Rail franchise*, Annex G, paragraph 21, and *Arriva plc and Sovereign Bus & Coach Company Ltd*, Appendix F, paragraph 18 (January 2005).
[4]In both cases, we used the higher of mid-week on-peak or mid-week off-peak frequency to determine whether the condition held.

TABLE 3 **Estimated proportion of EBL's revenues in the Eastbourne area arising from different categorizations of overlap flows, 24 February to 22 March 2008 (500m, filters applied)**

Flow overlaps between		*Number of flows*	*Revenue from flows £*	*Proportion of total revenue %*
Stagecoach/Cavendish/EBL	3-1	[✂]	[✂]	0
Cavendish/EBL	2-1	[✂]	[✂]	50
Cavendish/EBL/Southern	3-2 (incl rail)	[✂]	[✂]	4
Stagecoach/EBL/Southern	3-2 (incl rail)	[✂]	[✂]	0
EBL/Brighton & Hove	2-2	[✂]	[✂]	2
No overlap or minor overlap	1-1	[✂]	[✂]	44
Total revenue in the Eastbourne area			[✂]	100

Source: CC analysis of data provided by Stagecoach.

20. The results indicate that, based on March 2008 data, approximately 50 per cent of EBL's revenue came from flows on which its only effective competitor was Cavendish. A negligible amount of revenue came from the two flows on which all three merging parties were effective competitors. A small proportion of EBL's revenue (4 per cent) came from flows on which it effectively competed with Cavendish and Southern (ie rail service).

21. As noted in paragraph 3 (for the reasons explained in paragraphs 6.17 to 6.22 in the main report), we also looked at Cavendish's routes which were most likely to be profitable. As determined in Appendix H, route [✂] was the only one which was close to breaking even on a total cost basis. Table 4 reports the number of flows on which EBL's services overlapped with Cavendish's route and the total revenue earned by EBL on the overlapping flows. Table 4 shows that, once filters are applied, route [✂] overlaps with only [✂] EBL flows, and these flows account for only 0.3 per cent of EBL's revenues. As explained in paragraph 24, we note that there was actually a great deal of overlap between Cavendish's route [✂] and EBL's services; however, almost all flows are excluded by the filters because the relative frequency of Cavendish's 'individual' service (which in March 2008 was just once every [✂] minutes) is much lower than the 'combined frequency' of all EBL services running on these flows.

TABLE 4 **Estimated proportion of EBL's revenues in the Eastbourne area arising from overlap flows with Cavendish's route** [✂], **24 February to 22 March 2008 (500m, filters applied)**

Flow overlaps between	*Number of flows*	*Revenue from flows £*	*Proportion of total revenue %*
Cavendish route [✂]/EBL routes	[✂]	[✂]	0.3
Total EBL revenue		[✂]	

Source: CC analysis of data provided by Stagecoach.

Sensitivity analysis

22. We have also tested the sensitivity of our analysis to the assumptions used.

23. Looking first at all services operated in March 2008, Table 5 shows how the results in Table 3 change depending upon whether flows within 500m are aggregated and whether the frequency filters are applied. In all scenarios, EBL derives between 43 and 50 per cent of its revenue from flows on which there is competition either with Cavendish or both Stagecoach and Cavendish (but no-one else). It is always the

case that a higher percentage of revenue is derived from flows on which EBL competed only with Cavendish rather than with both Cavendish and Stagecoach. However, the effect of the frequency filters is to exclude Stagecoach services from overlaps as these services are relatively infrequent. The frequency filters also influence the proportion of revenue earned from flows on which Renown is active. Our findings are therefore not dependent upon particular filters and aggregation rules, as similar patterns of revenues arising from overlaps are found with and without these measures.

TABLE 5 **Estimated proportion of EBL's revenues arising from different categorizations of overlap flows, 24 February to 22 March 2008**

		Proportion of total revenue %			
		500m, filters applied	*500m, no filters*	*No 500m aggregation, filters applied*	*No 500m aggregation, no filters*
Stagecoach/Cavendish/EBL	3-1	0	20	0	11
Cavendish/EBL	2-1	50	30	43	39
Stagecoach/EBL	2-1	0	0	0	1
Cavendish/EBL/Brighton & Hove	3-2	0	2	0	2
Cavendish/Stagecoach/EBL/Southern	4-2 (incl rail)	0	0	0	0
Cavendish/EBL/Southern	3-2 (incl rail)	4	3	3	1
Stagecoach/EBL/Southern	3-2 (incl rail)	0	0	0	0
Cavendish/Stagecoach/EBL/Renown	4-2	0	12	0	9
Cavendish/Stagecoach/EBL/Southern/Renown	5-3 (incl rail)	0	2	0	2
EBL/Brighton & Hove	2-2	2	0	2	0
EBL/Southern	2-2 (incl rail)	0	0	0	0
No overlap or minor overlap	1-1	44	31	52	37

Source: CC analysis of data provided by Stagecoach.

24. We also looked at the effect of the filters on the overlap between Cavendish's route [✂] and EBL's services. As shown in Table 6, without any frequency filter, the level of overlap between this route and all EBL services is high, at 48 per cent.

25. Given the significant effect of the frequency filter on the proportion of EBL's revenue accounted for by overlap flows with Cavendish's route [✂], we tested the sensitivity of our findings to the particular specification of the frequency filters (see paragraph 18(b)) used.

26. Looking first at the 'frequent service' filter, where all EBL's services provide a frequency over a flow of at least one service every 10 minutes, we find that even if we increase the relevant frequency gap up to five times, ie from 10 to 50 minutes, overlapping flows still only account for the same 0.3 per cent of EBL's revenue. For the 'infrequent service' filter, the results show that our analysis is relatively more sensitive to changes in the frequency gap. However, infrequent services account for a very low proportion of EBL's revenues compared to frequent services and hence do not significantly affect the overall result. We therefore conclude that our findings are robust to large changes in the specific frequency filters used, and so the 'effective' overlap between Cavendish's route [✂] and EBL's services remains very small unless we were to believe that a significant proportion of passengers would not be concerned with long waiting times and the relative frequency of services, which seems very unlikely.

TABLE 6 **Estimated proportion of EBL's revenues in the Eastbourne area arising from overlap flows with Cavendish's route** [✂]**, 24 February to 22 March 2008 (500m, without filters)**

Flow overlaps between*	*Number of flows*	*Revenue from flows £*	*Proportion of total revenue %*
Cavendish route [✂]/EBL routes	[✂]	[✂]	48
Total EBL revenue		[✂]	

Source: CC analysis of data provided by Stagecoach.

*These include any flow overlaps between Cavendish's route [✂] and EBL's routes, including flows where other operators are active.

Barriers to entry

Introduction

1. This appendix focuses on entry into the provision of commercial bus services in the Eastbourne area. It sets out our views and evidence on:

   (a) barriers to entry (paragraphs 4 to 53);

   (b) ability and willingness for potential entrants to enter in the market (paragraphs 54 to 59); and

   (c) recent entry or expansion in the Eastbourne area (paragraphs 60 to 63).

2. The key issue we explore is whether entry (or the threat of entry) by a potential entrant would constrain the merged entity post-merger. For this to be the case, entry has to be easy, timely and sustainable.[1] We are interested in entry on a scale that is sufficiently large to provide an effective competitive constraint on the merged firm. Isolated small-scale entry, such as that limited to one single route, is unlikely to constrain the merged entity post-merger. However, a sufficient constraint may arise if a small-scale entrant has the ability and incentive to expand to a larger scale or if multiple small-scale entries occur.

3. Entry into commercial routes in the Eastbourne area might occur by: *(a)* operators that are active in the provision of *inter-urban commercial* bus services which start or end in the Eastbourne area (such as Go-Ahead),[2] or *(b)* operators that are active in the provision of *tendered* bus services in the Eastbourne area, or *(c)* operators that do not currently operate any commercial or tendered bus services in the Eastbourne area.

Barriers to entry

4. Stagecoach told us that the assets required to operate a bus service in the Eastbourne area were minimal and that barriers to entry to providing bus services were not significant. All the major national bus operators we spoke to expressed similar views.

5. In this appendix, we consider the following possible barriers to entry:

   (a) regulatory barriers;

   (b) access to facilities, the most important of which appear to be parking, maintenance and refuelling facilities;

   (c) economies of scale and other scale/size issues;

   (d) network ticketing; and

   (e) strategic barriers.

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[1] *CC2*, paragraph 3.45.

[2] In this case our primary focus is on entry by these operators into new commercial routes in the Eastbourne area rather than on expansion of service frequencies on their existing routes.

6. When considering barriers to entry into the provision of commercial bus services in the Eastbourne area, it is important to note that the scale of entry and the size of the potential entrant may be significant. There are a variety of possible models of entry into bus service provision—for example: very small scale with no dedicated facilities; an entrant using a small parking facility with refuelling and maintenance outsourced; small depots; outstations for parking supported by a depot some distance away; and entry with a large, dedicated depot. Entry on a small scale may be relatively less risky than entry at a larger scale (for example, if it involves a lower level of sunk investment), although the competitive constraint that such entry is able to exercise may well be weaker. On the other hand, small/local operators might face barriers that national operators would not face.

Regulatory barriers

7. There are a number of regulations affecting the provision of commercial bus services (see Appendix E). An essential requirement is that a bus operator must have a licence to operate (PSV operator's licence). This is granted by the Traffic Commissioner subject to satisfying certain criteria over the bus company's financial standing, reputation and professional competency. This licence can be revoked if there are failings in any of these areas or the vehicles can be taken off the road.

8. Once a bus company has a licence to operate services, it must then give 56 days' notice to register the routes it wishes to operate. After this notice has been given, the operator is then duty bound to operate that service according to its timetable. Any changes in the frequency or hours of operation of bus services, or changes, additions or removal of routes, must also be registered with the Traffic Commissioner, although sometimes this can be done at shorter notice than 56 days.

9. Neither Stagecoach nor any potential competitor considered obtaining the appropriate licence from the Traffic Commissioner a barrier to entry into the provision of commercial bus services.

10. In relation to other regulations, Stagecoach told us that restrictions on drivers' hours, the working time directive, EU proposals on insurance liability, pension commitments and disability discrimination legislation (which it said required physically larger vehicles that were more expensive both to own and operate in order to accommodate the same number of people), while not representing a barrier to entry, all significantly added to the costs of bus operation and deterred business initiative.

CC view on regulatory barriers

11. There is no evidence that the need to obtain a licence from the Traffic Commissioner or other regulations represent a barrier to entry. In particular, most of the other regulations seem likely to impact upon the variable (or semi-variable) costs of all bus companies, including incumbents. These do not seem to give rise to a material barrier to entry.

Access to facilities

12. An operator wishing to run commercial bus services in the Eastbourne area would require:

    (a) buses and drivers;

    (b) access to parking, maintenance and refuelling facilities; and

(c) access to back-office functions, such as IT, administration, payroll etc.

13. On the basis of the evidence collected, sourcing buses and hiring drivers or back-office functions do not seem likely to represent a significant barrier to entry in the Eastbourne area.

14. Parking, maintenance and refuelling services may be provided at a dedicated depot or may be contracted out separately to third-party providers. In this section, we will discuss the following issues: *(a)* whether it is necessary to have any of parking, maintenance or refuelling services provided in the proximity of Eastbourne; *(b)* the scope to obtain access to a proprietary dedicated depot in the vicinity of Eastbourne, either by acquiring an existing depot or by constructing a new depot from scratch (and the costs and timing involved); and *(c)* possible alternatives to a proprietary dedicated depot, including renting part of an existing depot owned by another (larger) operator, sharing a depot with other operators (including non-bus operators), and contracting out of parking, maintenance and refuelling services.

15. Overall, while Stagecoach argued that depots did not represent a barrier to entry, some potential entrants highlighted that a lack of depot facilities from which to operate the relevant buses represented the primary barrier to operating a new route.

Proximity to Eastbourne

16. Stagecoach told us that the bus depots it used to run services in and around Eastbourne were:

(a) EBL's depot located within Eastbourne: 50 buses housed at depot; 100 buses capacity; it served all Eastbourne routes; and

(b) Stagecoach's depot located at St Leonards-on-Sea (approximately 20 miles from Eastbourne): 61 buses housed at depot; 90 buses capacity; it served mainly local routes in Hastings, but also the two inter-urban routes into Eastbourne numbers 98 and 99.

17. Stagecoach submitted that:

(a) parking facilities which were acquired or rented by a new entrant need not be located in the immediate vicinity of Eastbourne; and

(b) similar to Cavendish, a new entrant would not require that maintenance facilities were located in the Eastbourne area.

18. As regards *(a)*, Stagecoach stated that buses had the ability to travel considerable distances between depots and the routes which they serviced. Elsewhere, however, Stagecoach noted that for supply-side substitution to take place, it must be feasible and economical for buses from a given depot to reach the start point of a given route in time to commence services. In particular, Stagecoach said that the costs of 'dead runs' from the depot to the route end would need to be taken into account, as such costs (which would be both opportunity costs and cash costs) would restrict supply-side substitution.

19. As regards *(b)*, we note that Cavendish operated its bus service business by renting a parking space in Polegate (approximately 6 miles from Eastbourne) and by relying on Renown's depot in Bexhill (approximately 12 miles from Eastbourne) for maintenance. Stagecoach told us that Cavendish used a local filling station in Eastbourne for refuelling, as this reduced the time-based costs involved in running vehicles to

Renown's facility in Bexhill, even if it meant that it paid a higher price for fuels than Renown's bulk supply. Stagecoach also told us that in the unlikely event that it were to operate Cavendish independently from EBL, it would have used a similar arrangement to the one Cavendish used pre-merger, that is it would have used a satellite facility in Eastbourne for parking and relied on its depot in St Leonards-on-Sea for maintenance.

20. Third-party evidence suggests that the proximity between the depot and the route end is an important factor in determining whether it is profitable to operate on a route. Go-Ahead told us that garaging facilities could be provided via a section of hard standing and a temporary building if maintenance facilities could be provided via a nearby depot (as Go-Ahead has done in other markets). However, Go-Ahead also told us that its depot in Brighton, approximately 27 miles from Eastbourne, would not be suitable to run a comprehensive bus service in Eastbourne. This is mainly due to congestion problems on the route to Eastbourne and the costs of running many empty buses to Eastbourne in the morning ('dead mileage'). Go-Ahead told us that, on balance, it would not be viable even if it made use of a satellite 'parking facility' in Eastbourne. This is because the Brighton depot is 1 hour away and therefore too far to ensure efficient and reliable maintenance. Coastal Coaches, which is based in Northiam approximately 31 miles from Eastbourne, told us that it had occasionally tendered for services in Eastbourne but its price was not competitive mainly because of the distance from its depot. Even Countryliner, which has a depot at Heathfield—approximately 17 miles away—said that it would be more interested in operating a new rural or inter-urban route beyond Eastbourne to Hailsham, Uckfield or Tunbridge Wells, so that it would be able to use one of its existing depots rather than having to locate another depot. Rotala told us that it was not interested in entering the Eastbourne market because it did not have a depot in the area.

Setting up a proprietary dedicated depot in or around the Eastbourne area

21. Stagecoach observed that, although there were no existing dedicated depots in operation in the Eastbourne area other than EBL's Birch Road depot, there was no shortage of sites and buildings in and around Eastbourne for potential use as a bus depot.

22. Go-Ahead confirmed that there were suitable sites for a depot in the Eastbourne area. It also said that the total cost of building a new depot from scratch (including the value of land) would range from £1.5 million to £3 million depending upon the specific circumstances (including the price of land which in turn depended on location, planning, environmental issues and the labour market etc). The timing required may be up to two years (although it could be as little as three to six months if it was possible to make use of existing facilities such as a truck depot rather than build from scratch). Arriva told us that it was impossible to give a definitive answer as to the costs and timings involved in building a depot from scratch because it was dependent on so many variables; however, it noted that the process could be shortened if the land acquired was already used for similar purposes (eg HGV). FirstGroup told us that building a depot from scratch might not be an expensive or time-consuming project. It told us that a safe and secure site would require only suitable surfacing, a Portakabin-type office, a bunded fuel tank and the appropriate maintenance facilities. It said that it had set up such a depot for 95 vehicles for the Commonwealth Games in 2002 at a cost of less than £10,000 excluding the land value and in less than six weeks. However, it also said that building a purpose-built depot with 'permanent' facilities would entail a longer time period and more expense.

Alternatives to a proprietary dedicated depot

23. Stagecoach told us that no bus operator would bother to purchase or construct buildings in which to park buses and that the only structural requirement was a maintenance facility which might be contracted out. In particular:

(a) There were vacant sites and properties to lease in the Eastbourne area for use as garaging facilities.[3] Furthermore, to the extent that there was spare parking capacity available at the depots of existing operators, this capacity could be subleased to new entrant operators.

(b) Similar to Cavendish, a new entrant would not require its own maintenance facilities. There were many local garages, dealers, small operators and hauliers which would carry out PCV maintenance.

(c) Refuelling could be carried out locally at filling stations or at third-party facilities.

24. Go-Ahead, Arriva and FirstGroup told us that parking space could be rented and maintenance work could easily be subcontracted to a locally-based third-party maintenance depot or shared facilities could be used. However, they all suggested that these solutions might be more suited to small-scale operations (see paragraph 30). Go-Ahead also said that in practice it was more usual also for small operators to have a proprietary depot.

CC view on access to facilities

25. On the basis of the evidence collected, we conclude that:

(a) Parking areas need to be located in the proximity of Eastbourne to run economic and reliable bus services within the Eastbourne area. Cavendish rented a parking space in Eastbourne and used a local filling station rather than run the whole business from Bexhill. Similarly, Stagecoach told us that it would have set up some parking arrangements in Eastbourne if it were to operate Cavendish independently from EBL. As regards maintenance, it appears that such services can be further away (because trips for maintenance are less frequent), but they still need to be reasonably close. Indeed, Cavendish used maintenance services from Bexhill at approximately 12 miles, but Go-Ahead told us that it could not rely on maintenance from Brighton at 27 miles.

(b) There appears to be a shortage of existing dedicated depots set up to provide parking and maintenance facilities in or near to the Eastbourne area.

(c) Whilst there may be sites in the Eastbourne area suitable for building new dedicated depot facilities, the set-up costs and timing involved are uncertain, as they depend on many variables (we will discuss this issue further in the following section).

(d) Whilst entry by renting parking space, subcontracting maintenance works and/or sharing facilities may in principle be an alternative to entry using a proprietary dedicated depot, the evidence suggests that this may be a more suitable option for small-scale operations (we will discuss this issue further in the following section). As regards sharing facilities, no one gave practical examples of possible

[3] These sites and buildings are available in the industrial areas in the east of Eastbourne near the A22 and also on Polegate's Chaucer Industrial Estate to the north of Eastbourne.

entry by sharing facilities with HGV operators or similar in Eastbourne. In addition, as regards leasing depot space, given that a depot needs to be located within or in the vicinity of Eastbourne, this only leaves EBL's depot and it is not clear that Stagecoach would have the incentive to lease capacity to a new entrant at a competitive price.[4]

Economies of scale

26. Economies of scale refer to the potential for a large-scale operator to enjoy an advantage because of the ability to operate at a lower average cost that derives from large operations. Scale-related average cost advantages may derive from fixed costs being spread over a larger quantity and/or from lower unitary variable costs. Where economies of scale are significant, this can give rise to a barrier to entry because new entrants or small-scale firms seeking to expand might find it difficult to achieve the minimum efficient scale.

27. In bus service provision, there are a variety of possible models of entry (see paragraph 6). As we discuss below, not all of these possible models of entry appear to be characterized by economies of scale.

28. Stagecoach submitted that:

(a) Economies of scale could be achieved in bus operation in locations such as Eastbourne, but so could diseconomies of scale. In particular, it argued that average costs per vehicle (including costs for available parking space, number of fitters/cleaning staff employed, number of available inspection pits, number of operational supervisors) normally decreased as the fleet increased, but this behaviour was not continuous and there were step changes that led to discrete increases in average costs (eg an extra fitter). Only where more than 50 vehicles were operated could these step changes be spread out to enable efficient additions to the fleet.

(b) While a small-scale entry could be viable with low overheads and a 35- to 45-bus operation could succeed and sustain overheads, a 25-bus operation could be unsustainable given that it would require a level of overhead cost that the current market volumes in the context of Eastbourne would not support.

29. Go-Ahead told us that scale efficiencies gave a company an advantage but they were not essential. It indicated that the 'tipping point' above which economies of scale materialized was in the region of 15 to 20 buses: beyond this point larger-scale operators were able to fully utilize in-house maintenance facilities (as well as to spread overheads over a larger number of buses). A major operator told us that as a general rule it would not have a 'depot' (ie with maintenance and repair facilities) unless about [✄] or more buses were based there.

30. As discussed in paragraph 24, large bus operators told us that: there were alternatives to a proprietary dedicated depot such as renting parking space and subcontracting maintenance work; these alternative solutions might be viable for small-scale operations; and the evidence showed that small businesses could be successful in the bus sector.[5] FirstGroup explained that this was the case because small-scale operations were less able to exploit economies of scale using depot facilities and

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[4]Stagecoach told us that it currently provided overnight parking in Eastbourne for five to six Brighton & Hove buses used on service 12.
[5]Go-Ahead told us that approximately 35 per cent of bus income was derived outside the five biggest bus companies.

therefore outsourcing might prove more cost effective. Go-Ahead said that solutions such as renting parking space and subcontracting maintenance work tended only to be viable for businesses operating somewhere in the region of 10 to 25 buses. A major operator told us that a fleet smaller than about [✄] buses would be based at a parking area or outstation and arrangements made for maintenance and repair at another base or depot.

CC view on economies of scale and ability to redeploy buses from depot(s)

31. Overall, we consider that:

(a) There are a range of models of entry which are characterized by different technologies (or cost functions). At the two extremes of this range, it is possible to identify a 'proprietary dedicated depot' model and a model where parking, maintenance and refuelling services are fully contracted out.

(b) The 'proprietary dedicated depot' model appears to be characterized by economies of scale. These arise from the fixed costs associated with the construction or acquisition of a dedicated depot and from lower unitary variable costs due, for example, to the full utilization of in-house maintenance facilities.

(c) We see no evidence of large-scale operations replicating and duplicating a model where parking, maintenance and refuelling services are fully contracted out. This seems to suggest that the 'proprietary dedicated depot' model is likely to be more attractive for large-scale operations and that there are limits on the size of operation which is attractive using alternative models.

(d) It appears that the 'proprietary dedicated depot' model is characterized by higher fixed costs and lower variable costs compared with the other models of entry. Higher fixed costs largely derive from the presence of depot costs, while lower variable costs are explained mainly by lower costs of in-house provision of parking, maintenance and refuelling services. While we have insufficient evidence to reach a conclusion as to whether a large-scale operator operating the 'proprietary dedicated depot' model would be more or less efficient than a small-scale operator operating an alternative model, the evidence shows examples of small-scale operators competing with large-scale operators.[6] This suggests that different business models may be economically viable.

(e) The difference between business models in terms of cost functions might also imply a difference in the level of sunk costs incurred in case of entry, where the main sunk cost would appear to be the investment in depot capacity.[7] We note that higher sunk costs imply a higher risk of entering into a new market, given that the initial investment cannot be fully recovered in case of exit, and may be reflected in a higher return on investment required in order to consider an entry opportunity profitable.

32. To conclude, it would seem that economies of scale restrict the way in which operators of different scales enter the market, but do not obviously prevent entry. Furthermore, although the extent to which the costs entailed by a large-scale entry with a proprietary dedicated depot would be sunk is uncertain, on the basis of the evidence collected it appears that such an entry strategy would be unlikely in the context of

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[6]Indeed Stagecoach provided several examples of this.
[7]Whether the investment in depot capacity can be considered entirely sunk depends on the possibility of recovering part of the investment upon exit from the market.

Eastbourne. Stagecoach currently provides a fairly comprehensive bus network with fewer than 50 vehicles and entry by a large-scale depot-based operator appears to be extremely risky using this particular model of operation as it would necessitate trying to force Stagecoach out of business.

Other scale/size issues

33. We observe that other features related to the scale of the operations and/or the size of the operators might convey an advantage over smaller competitors.

34. A large-scale operator may enjoy an advantage because of the operational flexibility of being able to redeploy buses over a 'portfolio' of routes in an area from its depots. An operator that serves a set of routes from the same depot can cost-effectively alter the allocation of resources among its individual routes in response to either a change in demand conditions (eg seasonal demand for bus services in Eastbourne with a peak during the summer) or a change in supply conditions (eg new entry or expansion on individual routes). Running such a portfolio of routes provides incumbent operators with knowledge of the area, brand awareness to passengers and flexibility to change their services at relatively short notice. Vehicle requirements to meet peak demand or to cover for breakdowns and other faults are also likely to be relatively less costly for large-scale operators, given their ability to cross-subsidize services across routes.

35. Large/national operators may also benefit from a greater purchasing power for certain inputs that entails price reductions when buying products and services in bulk.

Network ticketing

36. 'Network tickets' are any tickets which allow a customer to travel across the local network by changing buses without paying again and, in practice, include tickets valid for multiple journeys and daily or longer period zonal tickets. Generally these tickets are priced so as to be cheaper for a passenger making frequent journeys. An incumbent network operator may enjoy an advantage over potential entrants because operator-specific network tickets create a pre-commitment for customers to use a particular operator's services. In general, multi-operator network tickets, which allow bus passengers to use the same ticket on buses operated by different operators, tend to reduce the significance of the network advantage. In Eastbourne, the concessionary pass is in effect the main multi-operator network ticket.

37. In markets where network tickets are particularly important, entry may be difficult for two main reasons. First, there could be an issue related to the scope of the services provided (in terms of routes and/or frequencies). If customers want to make a series of interconnected journeys (ie they 'value' the network because of the existence of demand complementarities) and they are provided with operator-specific network tickets, they are not likely to switch to rival bus operators which are active on individual flows/routes only. Even if customers only want to make a series of journeys on the same route/flow (ie they 'do not value' the network), but they value frequency of service and they are able to purchase operator-specific network tickets, they may not be likely to switch to rival bus operators which provide a low-frequency service on that specific route/flow.

38. Second, there could be an issue related to the period of validity of the ticket. If customers purchase operator-specific network tickets that are valid over a period of time, they are unlikely to switch to rival bus operators during that period of time even if the

rival firms offer cheaper fares. The longer the ticket is valid for, the stronger the effect.

39. Stagecoach has network ticketing which is promoted nationally. It submitted that network ticketing did not constitute a barrier to entry in Eastbourne. According to Stagecoach, the majority of bus passengers travelling within Eastbourne used a single bus service only for their regular journeys. It told us that the small size of the town meant that the relevance of the network was minimal and the proportion of passengers switching bus services within a journey was insignificant. This, in Stagecoach's view, limited the potential network effects from network ticketing.

40. Going forward, Stagecoach said that it encouraged the use of multi-journey tickets, as they were key to its objectives of growing bus patronage. It explained that the primary function of network tickets was as point-to-point season tickets, with the advantage that they were not user specific. The passenger and revenue growth was generated by the simplicity and flexibility which made for easy marketing and promotion to non-bus users, who generally assumed that bus fares were more expensive than they actually were.

41. However, Rotala and Countryliner raised the issue that an incumbent large-scale operator running a bus network might have an advantage over small-scale operators due to its ability to offer network tickets.

CC view on network ticketing

42. Pre-merger data on passenger journeys by ticket type indicates that in 2008 operator-specific network tickets were used by around a third of EBL's passengers and 8 per cent of Cavendish's, or 56 per cent and 21 per cent of their fare-paying passengers respectively (see Appendix G, Table 1), showing that network tickets accounted for a non-trivial proportion of bus fare-paying passengers pre-merger. For the reasons set out in paragraph 17 of Appendix G (ie that many of these tickets were just used for return journeys), it seems likely that the proportion of passengers undertaking journeys on network tickets overestimates the proportion that actually values the ability to undertake journeys across the network, particularly for EBL.

43. We note that Stagecoach's 'mini business plan' states that: *(a)* sales of weekly Megarider tickets to regular users in Hastings and in the Thanet area had increased over the past four years at approximately [✂] per cent a year and over [✂] per cent a year respectively; and *(b)* Stagecoach said that it intended to provide in Eastbourne a full range of affordable, value-for-money discount tickets based on the highly successful Dayrider and Megarider range, which were acknowledged to offer some of the lowest fares in the UK. This seems to suggest that one likely effect of the mergers is to enhance the coverage of Stagecoach's network tickets compared with EBL's and Cavendish's coverage pre-merger.

44. We consider that:

(a) network tickets could give rise to a barrier to entry in Eastbourne in so far as small-scale potential entrants (eg running one route only) may find it more difficult to compete for Stagecoach's customers that want to make a series of interconnected journeys (ie that 'value' the network) and are provided with operator-specific network tickets; and

(b) network tickets could give rise to a barrier to entry in Eastbourne also in so far as small-scale potential entrants (eg running infrequent services on one route) may find it more difficult to compete for Stagecoach's customers that value frequency

of service and are provided with operator-specific network tickets, even if those customers want to make return journeys only on one specific flow/route (ie they ‘do not value’ the network).

45. In relation to *(a),* as set out in paragraph 18 of Appendix G, overall the evidence on whether a significant group of customers within the Eastbourne area places value on demand complementarities between routes is not persuasive; network ticket sales may largely reflect the ticket pricing structures that have been adopted. Therefore we conclude that demand complementarities over the network do not give rise to a substantial barrier to entry.

46. In relation to *(b)*, we do not have evidence to suggest that enough customers attach weight to frequency aspects to conclude that network tickets give rise to a substantial barrier to entry.

47. We also consider that network tickets are unlikely to give rise to a barrier to entry in Eastbourne because customers are tied into long-period tickets: the network tickets currently existing in Eastbourne are generally issued for a maximum of one week period and this is too short a period of time for a substantial incumbent’s advantage to arise.

Strategic barriers

48. Potential entrants might be deterred from entry into the provision of commercial bus services in Eastbourne if they consider that Stagecoach is likely to react robustly to new entry. This perception needs not derive from having directly suffered from such actions in the past; observing such behaviour by similar incumbents against entrants in similar circumstances to its own may be enough to discourage entry.

49. We would expect an incumbent operator to react normally to entry by possibly increasing service levels or cutting fares. It is also possible that an incumbent may choose to respond in a way which is not a short-term optimal reaction, in the hope of damaging the entrant so as to realize long-term benefits. Actions could include more substantial fare cuts, increases in service frequency, or changing timings so as to run just ahead of a rival’s services (and so be more likely to pick up customers).[8] This would be done for the objective of driving an entrant out of the market or deterring the entrant from entering in the first place (as well as deterring others from entering in the future).

50. The perception by third-party bus operators of Stagecoach’s likelihood of responding robustly to entry will depend upon their view of Stagecoach’s ability and incentive to engage in such behaviour. An incumbent’s ability to respond robustly to competition will depend upon its financial strength. The cost of robust behaviour against relatively small rivals may make little difference to the overall profitability of a large group, while small/local rivals may find it difficult to survive even with relatively small losses for a short period. Where this behaviour entails ‘losses’ for the incumbent (if not actual losses, a sacrifice of profits) in the short run, but is expected to lead to an increase in profits in the long run, such behaviour can be profitable to the incumbent if it leads to the exit of the competitor or it deters the entrant from entering and if it confers a reputation that effectively deters other entries in the market and/or in other markets in the future. Stagecoach is a national player operating throughout the UK across many local markets. As such, it may be perceived to have an incentive to respond robustly

[8]At the extreme, reactions could be sufficiently vigorous to be considered predatory in nature, ie services may be operated below cost.

against entry in a local market as this can build a reputation that benefits it in other bus markets.

51. Stagecoach told us that its reputation was mixed. It said that if it felt that a new entrant was a serious threat, it would compete against it and might increase frequency and reduce price (legally). In regard to the threat of entry from small operators, Stagecoach said that: ‘I think most of them respect us for doing an extremely good job and would think long and hard before they chose to compete with us because they know that we would respond robustly’, and ‘If we felt they were a serious threat we would compete against them. Yes, we would make decisions which might include increasing frequency, might include reducing price legally …’.

52. Arriva told us that a small part of its considerations in not entering was that an operator with the resources of Stagecoach would be able to respond quickly to any entry by adjusting any frequency reduction or unmerited increase in fares to get them back (up or down as the case may be) to competitive level. Countryliner indicated that it would not be prepared to enter into the provision of commercial bus services in an area where Stagecoach was the incumbent because of its reputation to respond aggressively to competition.

CC view on strategic barriers

53. On the basis of its likely incentives and ability to act, and the evidence provided by Stagecoach and third parties, we consider that Stagecoach’s reputation of reacting to competition might represent a significant barrier to entry. It seems likely that this could apply to entrants of any size.

Potential for entry

54. In relation to the potential for entry after the merger, Stagecoach told us that:

(a) There were always competitors watching the market for possible entry opportunities, but the degree to which it would observe entry in practice was unpredictable: if it were to drop its standards or try to take advantage of the market, it would increase the probability of entry to the point where it became a certainty.

(b) Operators of tendered services within Eastbourne represented potential competition in respect of commercial services, particularly if Stagecoach was to increase fares or reduce service levels. It was often the case that operators supplemented tendered services (which had fewer capital requirements and were less risky than commercial services) and then expanded from this basis to start running commercial services along the same routes as an existing established operator.

(c) On balance, if it were to implement marginal frequency reductions or marginal fare increases, then, in most cases, it would be unlikely to invite competition immediately, but it would invite somebody to look. It would expect large-scale entry only if there were pretty large-scale failure.

55. Stagecoach provided us with a list of potential entrants into the provision of commercial bus services in the Eastbourne area in order of likelihood.

56. We asked potential competitors whether they would consider providing commercial bus services in the Eastbourne area and what factors would influence this decision.

57. Of the major national bus operators, none told us that it would be interested in entering into the Eastbourne area in response to small but significant price increases or frequency reductions. [✂] said that its expansion on new commercial routes in Eastbourne was unlikely and that only a major increase in demand for bus services or a significant and long-lasting worsening of service provision (in terms of fares, frequencies, quality of the fleet) by the incumbent operator might lead it to consider expanding its services into new routes. [✂] told us that a 10 per cent increase in price would not be enough for it to consider expanding, and an increase in price somewhere in the region of 50 per cent together with a reduction in service level would be required. This was because it believed that the Eastbourne market was too small to sustain head-to-head competition on urban routes between two quality operators: it told us that the Eastbourne market was around 50 buses and it would probably need to go well below half that number before any thoughts of a competitive incursion would be made. However, [✂] told us that entry on a smaller scale might be attractive for someone who already had facilities in place (eg a coach operator entering the market with four to five buses). [✂] told us that it had no intention of entering into the Eastbourne area because the area was adequately served by Stagecoach and Go-Ahead and because the area could not readily be integrated into [✂] network. [✂] also indicated that one of the reasons for not entering was the potential competitive reaction of Stagecoach. [✂]

58. Among small operators, Renown told us that it would consider re-entering into the commercial bus business in Eastbourne (after the expiry of the non-compete clause with Stagecoach) if Stagecoach reduced its services and performance substantially. However, it told us that it would not enter the market if just fares were to increase. Countryliner expressed the view that it would consider entering on a single-route basis if an existing large operator withdrew a particular route as not viable but it was viable for a small operator to serve. This entry would be more likely if the route extended beyond Eastbourne to Hailsham, Uckfield or Tunbridge Wells.

CC view on potential for entry

59. On the basis of the evidence discussed above, we consider that entry into the provision of commercial bus services in the Eastbourne area appears in general to be unlikely in response to higher prices (5 to 10 per cent) or marginal reductions in service levels applied by Stagecoach.

History of entry or expansion in the Eastbourne area

60. We considered the extent of actual entry and expansion in the provision of commercial bus services in the Eastbourne area during the past ten years.

61. Stagecoach told us that entry in Eastbourne had been on a small scale and that EBL had been the primary operator within Eastbourne for the majority of the past ten years (and indeed for longer).

62. As regards the main events involving entry into or expansion in the provision of commercial bus services, Stagecoach submitted that:[9]

(a) the entry of Cavendish in 2006 was the only example of a new operator entering the commercial market in Eastbourne in the last ten years; and

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[9]The tendered bus service business appears to have been more dynamic with a number of small/local operators bidding for ESCC local bus tenders.

(b) Stagecoach reduced its presence in the Eastbourne area by selling the Hailsham corridor routes to EBL in 2002 and the Lewes depot operations serving the Brighton–Eastbourne route (route 12) to Brighton & Hove in 2005. As a result, Brighton & Hove became the sole provider on route 12.

CC view on history of entry or expansion

63. The evidence discussed above shows that, excluding Cavendish's entry experience, the provision of commercial bus services in the Eastbourne area has involved only two expansions through acquisition on a single route in the last ten years.

Entry into the provision of tendered services

64. We note that different market conditions apply in the provision of tendered services, as shown by a larger number of suppliers, many of which are relatively small. Because tendered services provide a guaranteed business once the contract has been won, and contracts are placed for individual routes or services, a small scale of operation (without any significant sunk cost or investment in depots) can be attractive. Further, there is no ability for alternative operators to respond robustly against an entrant on the route(s) in question once it has won a contract as its business has been secured.

Glossary

Act	Enterprise Act 2002.
Actual loss	Within a critical loss analysis, the actual loss is the likely loss of sales (in percentage terms) associated with a price rise of the hypothesized amount, which can be compared to the critical loss threshold.
Arriva	Arriva PLC—a UK-based transport company that operates buses and trains in the UK and Europe.
BRAG	Bexhill Rail Action Group—campaigns for improvements to rail services in the Bexhill and surrounding area.
Brighton & Hove	Brighton & Hove Bus & Coach Company Limited—operates a service between Brighton and Eastbourne and is part of the **Go-Ahead** Group.
Bus route	A service provided by a bus operator under a particular number.
Catchment area	The geographical area around a bus stop in which passengers are likely to travel to that bus stop.
Cavendish	Cavendish Motor Services Limited—sister company of **Renown** until its purchase by **Stagecoach**.
Coastal Coaches	Private bus and coach operator of **tendered services**.
Commercial services	Bus services other than **tendered services**.
Concessionary fare scheme	A scheme made by a county or district council under the Transport Act 1985 enabling the elderly, the disabled or children to travel on buses free or at reduced fares. The Concessionary Bus Travel Act 2007 provides that everyone aged 60 and over or disabled can travel free, off-peak, on all local buses in England.
Countryliner	Countryliner Coach Hire Limited.
Confidence interval	A confidence interval is used to show a range of uncertainty around an estimated number. It shows the range that we expect the true estimate to lie within 95 per cent of the time.
Critical loss	The critical loss is the maximum amount by which sales of the product(s) or service(s) in question can fall (in percentage terms) following a hypothesized price increase, which still ensures that the hypothetical monopolist's profits do not decline.
Demand-complementarities	When the utility derived from consumption of one product or service is enhanced by the consumption of other products or services. In bus service provision, passengers may value a network of routes more than the sum of each individual route.
Depot	A facility where buses can be parked when not in service, and which may include maintenance and refuelling facilities.

Direct costs	A bus operator's direct costs include its drivers' costs, fuel costs, tyres and costs for licences and insurance.
DfT	The Department for Transport.
ESCC	East Sussex County Council.
Eastbourne area	The area around and including Eastbourne which was served by **Cavendish**, **EBL** and **Stagecoach** prior to the mergers, excluding parts of **EBL**'s and **Stagecoach**'s inter-urban services. We have treated this as approximating to the Eastbourne Borough, and the Hailsham, Pevensey and Polegate sectors of Wealden district.
EBC	Eastbourne Borough Council—the local council for Eastbourne, former majority owner of **EBL**.
EBITDA	Earnings before interest, tax, depreciation and amortization.
EBL	Eastbourne Buses Limited. It was the municipal bus operator prior to its acquisition by **Stagecoach** and provides local bus services in the Eastbourne area and some inter-urban services.
EV	Enterprise value, a measure of a firm's value equal to the market values of: (i) the firm's issued shares (equity value); plus (ii) its net debt (total debt less cash and liquid investments); plus (iii) minority interest and associates.
FirstGroup	FirstGroup PLC.
Flow	A particular bus journey between start and end points, which may be all or part of a longer bus route (and does not necessitate changing buses to connect with a different route).
Go-Ahead	Go-Ahead Group PLC.
Head-to-head competition	Where two or more bus operators provide competing bus services running over the same flows and so are alternative ways for customers to travel the same journey.
Honey Barrett	Honey Barrett Limited, a firm of chartered accountants based in Eastbourne and Bexhill, who were **EBL**'s auditors prior to its sale.
Inter-urban	Routes that run between urban centres.
Keolis	Keolis SA, a French transport group and former minority shareholder in **EBL**, through its UK subsidiary, Keolis (UK) Limited.
Local Transport Plan	Sets out a local authority's local transport strategies and policies, and an implementation programme.
MCL	The Martlets Consultancy Limited, a firm specializing in public and passenger transport. It currently administers concessionary free travel schemes on behalf of more than 100 local authorities. These management services are delivered by a wholly-owned subsidiary MCL Transport Consultants Ltd.

Multi-operator ticket	Tickets which are accepted by other operators as well as by the operator that issued it.
Network	A collection of interconnected routes. This can be defined in relation to a particular operator's services or a wider geographical area.
Network ticket	Used mainly to refer to tickets that allow travelling on more than one route, usually over a period of time, for example weekly or monthly, only on the services of one operator.
Off-peak travel	Travel from 9.30 am until 11.00 pm weekdays and all day week-ends and bank holidays.
OFT	Office of Fair Trading.
On-bus revenue	Income taken on the bus as a result of direct ticket sales.
Overlap flow	A flow on which any two firms operate a service.
Own price elasticity	The extent to which, for example, demand for a bus service would respond to an increase in price.
Oxera	OXERA Consulting Ltd.
Pathfinder ticketing scheme	Scheme in East Sussex enabling children to purchase a week's travel at a discounted rate.
Potential competition	Potential for **head-to-head competition** on bus routes in Eastbourne that in itself could act as a significant competitive constraint.
Renown	Renown Coaches Limited, former sister company of **Cavendish** until it was acquired by **Stagecoach**.
Return ticket	A return ticket for travel along a specified flow.
Rotala	Rotala Plc.
Single ticket	A one-way ticket for travel along a specified flow.
SLC	Substantial lessening of competition.
Southern	Southern Rail Services. Provides rail services in South London and between central London and the South Coast, through East and West Sussex and Surrey, and parts of Kent and Hampshire.
SSNIP	Small but significant non-transitory increase in price.
Stagecoach	Stagecoach Group PLC.
Stagecoach Bus Holdings Limited	Owned by Stagecoach Group PLC, a holding company for 20 regional operating units involved in the provision of local and regional bus transport services in more than 100 towns and cities in the UK.

Stagecoach in East Kent and East Sussex	Stagecoach's operating unit that includes bus services run from the Eastbourne depot.
Sussex Countrywide Concessionary Travel Scheme	Scheme that sets out the payment schedule for operators and a formula for reimbursement of concessionary fares.
Tendered services	Services operated under contract to local authorities, which seek tenders for doing so; these services are not operated commercially.
Traffic Commissioner	Appointed by Secretary of State for Transport, Traffic Commissioners have responsibility in their area for the licensing of the operators of buses and coaches and the registration of local bus services.
Travel to work area	An area where the population would generally commute to a larger town, city or conurbation for the purposes of employment.
Voluntary Partnership Agreements	A non-statutory agreement between a local authority and one or more bus operators, where the local authority agrees to provide facilities or operational benefits (for example, improved facilities such as bus shelters, bus stations and bus lanes), while the bus operator undertakes to provide bus services of a particular standard.