

Andrew Murray
Deputy Director Rail Performance & Operations
Rail Commercial
Department for Transport
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12 February 2014

Dear Mr Murray,

Thank you for your email addressed to Rachel Gilliland, dated 24th January 2014 regarding Alliance Rail Holding's (Alliance) Section 17 proposal. It is encouraging that the government values the benefits of competition that open access can bring. This was echoed in the Houses of Parliament on the 23rd January 2014 when Stephen Hammond MP stated, in reply to a question from Therese Coffey MP:

“Open access operators have helped to provide innovative services for passengers and have helped to grow new rail markets—often with excellent passenger satisfaction scores. The additional competitive pressure in the market provided by open access can also improve the experience of passengers of franchised services”.

It is therefore disappointing that the Department for Transport has responded to this consultation with the same unsubstantiated and negative arguments it has used on a number of previous occasions.

To state that *“Open access operators are being subsidised by passengers on franchised services which are paying full track access charges to support the maintenance and operation of the network”* is incorrect and misleading. Open access and franchised operators both pay the variable usage charge. This charge is the best measure of the costs directly incurred by Network Rail as a result of the specific train service being operated. In addition franchised operators pay a fixed access charge, which is a mark-up paid over and above the costs directly incurred by Network Rail to allow it to obtain full recovery of its costs.

Fixed access charges are a residual figure calculated by deducting the variable usage charge and network grant from Network Rail's total revenue requirement, and so they are an “artificial construct”, as stated by Mr Justice Sullivan in the case of (the then) *GNER and the ORR & others [2006]*, and do not represent the actual cost directly incurred by Network Rail

in maintaining a specific section of route a specific train service operates over. The fixed track access charge forms part of the industry money go round and reduces the network grant, but it need not be paid by franchised operators as it could be paid via the network grant.

Franchised operators and open access operators are also considered to be in different market segments by the Office of Rail Regulation (ORR) as a result of the way in which access to the network is gained. Imposing the fixed access charge on open access operators would be contrary to non-discriminatory principles, on which mark-ups may be levied under paragraph 2 (I) Access Management Regulations 2005 (“AMR”). The issue of open access operators paying a fixed access charge was argued by GNER in GNER and the ORR & others [2006]. GNER lost its case and the legal position was clearly established. The Department has not challenged the decision. To suggest the decision is wrong would go against the established case law and would be illegal.

You state that where franchise bidders perceive a risk of open access competition they are likely to offer much lower bids. Perhaps you could provide some evidence to support this statement. The only time this has been tested was on the ECML, when GNER’s franchise failed and, at re-bidding, National Express, despite the presence of more open access competition¹, bid a higher premium. Since then the ECML has seen increased open access activity, but the East Coast operator has annually increased its premium payments.

You also identify that a lower bid detrimentally impacts on the taxpayers interest by putting further pressure on fares and making it harder to deliver the rail upgrades that passengers want. Ignoring for a moment the fact there is no evidence to support that lower bids will be received, this contradicts your first statement that the government values the benefits that open access can bring and the statement made by the Rail Minister Stephen Hammond MP. Your statement also seems to indicate that the Department would not wish to see lower fares for passengers as a result of competition. Bearing in mind passengers are now the largest funders of the railway, this is particularly disappointing and shows a lack of understanding of how a competitive market works.

There is now empirical evidence² to show that, where open access competition exists (e.g. York to London), fares have increased at a much lower rate than at stations where no competition exists. Yet, as mentioned earlier, the East Coast operator has continued to increase its premium payment year on year. Given the appalling track record of the Department in its management of the West Coast Main Line franchise bidding process and the significant loss to the taxpayer in this respect (estimated at over £100m), it is difficult to take your concerns seriously.

Your comment regarding overtaking of slower services is noted. Our proposals will require services to make optimum use of the infrastructure, and we expect that this will be in

¹ Long distance open access services on the ECML now account for over 16% of the paths operated.

² Rail’s Second Chance – Centre for Policy Studies

accordance with the established industry rules contained in the Network Code and within the available contractual flex contained in operators' contracts. There is nothing that prevents this approach by Network Rail, and indeed it is to be encouraged. In addition, we are also mindful of the provisions of Para 18 (5) of the Railways Infrastructure (Access and Management) Regulations 2005 ("AMR"). The Department is the custodian of the AMR and will be fully aware that if a better use of the infrastructure is found then the contractual rights can be changed.

Regarding your request for a specimen timetable, Alliance has developed an indicative timetable for its proposals. This timetable is confidential, although it will be shared with the ORR upon submission of the application. This approach is common practice across the industry as Northern's May 2014 timetable was also declared as commercially confidential even after the formal timetable bid was made. Irrespective of that, the provision of a timetable at this stage has absolutely no value in determining capacity, and when we have shared information in the past, some consultees have undertaken a pointless exercise in trying to evaluate a future timetable alongside current paths in a desperate attempt to 'prove' that paths don't work.

Alliance is aware of the Department's arrangement with Hitachi for Super Express Trains. As a result of the delivery times it is unlikely that the future East Coast operator will be able to deliver an additional train per hour from London King's Cross before December 2018, by which time the majority of CP5 interventions will be complete, providing additional capacity. Alliance would welcome sight of the application you propose for this additional service.

You state that you would welcome assurance that returns on investment made by the taxpayer in these new trains would not be jeopardised. It is misleading to suggest that the investment in these trains is being made by the taxpayer. Alliance understands that the finance for the new fleet will be sourced from a number of commercial banks and the lease payments made by the new franchise holder to Agility Trains will pay off these loans over 27½ years. This makes it clear that the investment will be funded by the fare-paying passenger, rather than the taxpayer – unless, of course, the Department is expecting the new East Coast franchise to require an operating subsidy.

Alliance's rolling stock will also be funded entirely privately. There is no risk that it will be a burden on the taxpayer by way of a subsidy, because the government will not be underwriting the contract. The rail industry was privatised to encourage commercial investment and competition. The Department should be mindful of this fact and of the impact its current policies have on impeding competition. This does not result in value for money for the taxpayer, the passenger or for the government.

The Department has asked for assurances from Alliance that the *"the returns on investment made by taxpayers in these new trains and in CP5 infrastructure enhancement would not be jeopardised by the approval of the application"*. We have already commented on the 'taxpayer' element, and it is not for Alliance to review the Department's business case which,

in any case, we do not have sight of. The Department should have sought to protect any investment that it has made by way of the accepted means it has at its disposal. It has not sought to do this so we can only conclude that it has perceived there is little or no risk.

It is also our view that use of the IEP rolling stock will not be jeopardised if Alliance's application is successful. There are a number of other opportunities where aged inter-city trains could be replaced if not all were required on the ECML.

We have been advised by the Department's representatives at industry meetings that the future franchise requirement is for six long-distance franchised services to operate in each off-peak hour. There will certainly be enough capacity for these and existing open access services by the time all CP4³ capacity enhancement schemes are complete, even if a timetable recast is needed to make best use of that capacity. The current proposals for CP5⁴ infrastructure investments are aimed at further increasing capacity and improving journey times.

In line with Paragraph 18(5) of the AMR, Alliance is seeking to make best use of the capacity and line-speed enhancements. Alliance is of the view that, in the light of this clause, its proposal will need to be fully evaluated even if no spare capacity appears to exist. If no capacity exists, the route will need to be declared congested by Network Rail and a suitable plan prepared to address the congestion.

It is also worthwhile noting that the Department's East Coast Trains has recently withdrawn its proposals for additional competing services to Edinburgh contained in its 44th Supplemental Agreement. As this was a supported application it is clear that additional capacity currently exists and was identified by Network Rail.

Alliance is confident that any risk to performance and operations will be minimal, and certainly no greater than the introduction of any further franchised IEP services, or alongside an increase in trains running at less than 125 mph.

With regards to the funds available to the Secretary of State, the ORR applies the 'not primarily abstractive' test, which aims to ensure that applicants for open access routes will generate at least 30p of new revenue for every £1 of existing revenue which is abstracted from other operators. The ORR has concluded that if the open access operator generates any less new revenue, the benefits of their operation would not outweigh the costs.

The government policy, as recently re-stated by Rail Minister Stephen Hammond MP, is *"to support the not primarily abstractive test in its current form"*, and *"our assessment is*

³ CP4 Delivery Plan – Programme 18 – ECML improvements (July 2013) shows as outputs:

- Up to one additional long distance high speed passenger path per hour off peak
- Up to two additional long distance high speed passenger paths in each peak hour

This is delivered via a significant number of scheme outputs.

⁴ The Secretary of State ... *"seeks further improvement in capacity and reduction in journey times"*.

that for this very different part of the rail market the open access system works well for both customers and the public purse”.

The Alliance proposal comfortably exceeds the threshold set by the ORR, and as acknowledged by the government, offers a service that will work well for both customers and the public purse.

Yours sincerely,



Ian Yeowart
Managing Director