

Phil Dawson  
Regulation and Track Access Manager  
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12 February 2014

Dear Phil,

**Great North Eastern Railway Ltd (“GNER”) S17 Application**

Thank you for your response; this is Alliance Rail Holdings’ (Alliance) response on behalf of GNER. For clarity GNER is a subsidiary company of Alliance Rail Holdings Ltd.

I am sure you are aware that the government values the benefits of competition that open access can bring and this was echoed in the Houses of Parliament on the 23<sup>rd</sup> January 2014 when Rail Minister Stephen Hammond MP stated:

*“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”.*

**Revenue Abstraction**

The industry test that is used to balance the level of abstraction against the level of generation to assess the impact on the Secretary of State’s funds is the ‘Not Primarily Abstractive’ (NPA) test. In his further comments on 23<sup>rd</sup> January 2014 the Rail Minister stated:

*“These beneficial impacts must be balanced against the potential to abstract passenger revenue from franchised operators. This abstraction primarily manifests itself as a cost to Government in the form of diminished value of the franchises when they are tendered.*

*In an attempt to mitigate this problem, the Office of Rail Regulation (“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 franchised 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. Our policy is to support the not primarily abstractive test in its current form.”*

We can confirm that the proposed GNER service comfortably exceeds the NPA threshold.

## **Capacity**

You comment that you believe that the paths would need to be “*hardwired*”, but this is not the case - and in any event you will be aware it would be illegal to do so. Our proposal will require services to make optimum use of the infrastructure, and we expect that this will be in 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. We are also mindful of the provisions of Para 18 (5) of the Railways Infrastructure (Access and Management) Regulations 2005 (“AMR”). In essence this clause states that if a better use of the infrastructure is found, then the contractual rights can be changed.

We also note your statement that this proposal “*would undermine the overall integrity of the ECML timetable, reducing connectivity, extending journey times to other destinations and further reducing the value of this franchise to the government.*” This statement is without foundation, and perhaps you could provide some evidence to support it. Franchise value has been tested previously on the ECML, when [the then] GNER franchise failed. At re-bidding, National Express, despite the presence of more open access competition<sup>1</sup>, 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 in the face of that increased competition.

There is now empirical evidence<sup>2</sup> 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.

We note your comments regarding the timing of a recast and welcome your commitment to a recast to take into account the infrastructure interventions and the introduction of the Class 800 fleet. The Calendar of Events, as published by Network Rail, lists a recast in both December 2016 and December 2018.

You also state “*before the ORR makes any decision on this proposal, we believe that it should take into account alternative applications from the franchise operator. Given the refranchising competition, this may require waiting for the successor operator to make an application*”. We recognise that when there are competing applications, ORR will need to

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

<sup>2</sup> Rail’s Second Chance – Centre for Policy Studies

consider them together. However, we would object to any delay caused by considering aspirations of operators, which are not backed up by an application, and we would refer you to the ORR 'East Coast Lessons Learned' (ECLL) document of 2010 which highlighted the continual delay brought to the process by such behaviour – which unnecessarily delayed the introduction of the Grand Central Bradford service by two years.

In addition, we disagree that our application should be delayed pending the outcome of the franchise competition and the successful operator making an application, and would again refer you to the ECLL. Under the AMR, the ORR must make a decision on applications within two months of receiving all relevant information. Alliance's experience with its West Coast Main Line application is that it becomes increasingly difficult for a fair and reasonable decision to be reached the longer it is deferred. In that case, we are still awaiting a decision two years after the application was made. In the interim, the franchise process collapsed when it was found to be severely flawed and so it was placed on hold, costing the taxpayer an estimated £100 million.

### **Access Charges**

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. Neither the DfT or any franchisee has challenged the decision, and to suggest the decision is wrong would go against the established case law and would be illegal.

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In addition your comments seem to suggest that open access services should only operate at the margins. We are not aware of any evidence to support this belief: no such reference is made in the Criteria & Procedures or Moderation of Competition documents, and any attempt to enforce this approach would go against EU and UK laws, particularly in relation to the Competition Act.

The business case for this application takes into account that GNER will be paying a significantly higher capacity charge per train mile than existing open access operators on the ECML.

You also raised a number of specific questions, and we have provided the responses below:

**What provides Alliance with such confidence that capacity will be available to deliver this proposal from December 2016?**

With CP4 interventions creating further capacity<sup>3</sup> - and work currently being undertaken during CP5 with the Connectivity Fund<sup>4</sup> - then it is more than reasonable to expect the significant investment made in the infrastructure will deliver what is promised – further capacity and journey time improvements.

In addition, we will work with Network Rail to use all the available tools to deliver this proposal in order to optimise the timetable.

**To what extent does Alliance believe that a timetable recast is required....?**

A timetable recast will be required in order to optimise the timetable, and this will be required for all operators to maximise the investment in the infrastructure. The Calendar of Events identifies timetable recasts for both December 2016 and December 2018.

***Does Alliance believe that this proposal can be delivered if East Coast's access rights continue in their current form beyond Dec 2016?***

The access rights of East Coast were amended in 2011; part B of schedule 5 contains the current level of protection. We have analysed the format of schedule 5 in order to answer your question. On examining the current access rights of East Coast, it becomes evident that more flexibility would have to be sought in any forthcoming application by East Coast.

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<sup>3</sup> 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.

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

The use of “A” and “B” notations is a way to specify in great detail the different calling patterns as firm rights. This format is confusing and does not make it easy to determine what services are operating under which access right.

In the clockface table a flex of only 3 minutes is permitted – this will have to be increased to +/-30 minutes to give Network Rail the flexibility it seeks.

In the specified equipment tables the firm rights to two different types of rolling stock should be replaced with one type, when the two types do not have the same performance characteristics. Having a firm right to a class 91 set and a firm right to a HST 2+9 for the same service wastes capacity and ossifies the Network.

The journey times are too highly specified, there should be less use of the “A” and “B” split based on calling patterns.

It would not be credible for East Coast to seek to progress a new contract based on the current level of rights. These rights, when expressed, show a high degree of unacceptable hardwiring and they are not easy to understand. Indeed this is demonstrated by East Coast’s 44<sup>th</sup> Supplemental agreement. Part of this Supplemental was to include access rights for services that were operating in the current timetable and that did not have any rights. It is clear from this fact that the East Coast contract is unmanageable.

So the short answer to your question is “no”. The East Coast contract format will need to be made a good deal more flexible and simplified so that East Coast can understand what access rights it has and so that the best use of the infrastructure can be made.

**Does Alliance believe that this proposal will still be financially viable should the proposed journey times of 3h43 prove to be undeliverable? For example 4h20 would the proposal be viable?**

The viability depends on achieving a faster journey time than 4h20: that is made clear in the application. The point at which it becomes potentially ‘unviable’ due to length of journey time is commercially confidential. Alliance will be sharing its business plan with the ORR to support its application.

However, it is important that Network Rail is not constrained by highly prescriptive access rights, a position we understand. This is why it is important that East Coast’s rights need to be significantly more flexible so that optimum use of the infrastructure can be achieved and allow faster journey times for both Alliance and the new East Coast franchise.

**To what extent does Alliance believe that their proposals and in particular stated journey time aspirations would impact on other services currently operating on the ECML, in particular, those long distance services operated by the current operator of East Coast?**

We would hope that the competition would induce East Coast to rise to the challenge and seek to improve its existing services as indeed it has done so far. Our proposals will require services to make optimum use of the infrastructure, and we expect that this will be in accordance with the established industry rules contained in the Network Code and within the available contractual flex contained in operators contracts.

Before the Super Express Train (SET) is introduced on the ECML, Alliance trains would need to overtake the slower of the two Newcastle/Edinburgh trains in order to meet its journey time aspirations. We believe this can be achieved with no impact on end-to-end journey times for East Coast, and with minimal impact on intermediate timings. I would point out that a key objective of the ECML Connectivity Programme is to facilitate the overtaking of slower trains by faster ones.

However, once the SET is operational we would expect the only East Coast franchise train to be overtaken would be an all stations stopper, should such a service be included in the franchise specification. Best use of the network dictates that it is reasonable that these trains should be overtaken en route.

**East Coast notes the ORR’s Moderation of Competition – Final Conclusions: “The Regulator acknowledges that competing services that are primarily abstractive of incumbents’ revenue without compensating economic benefits – cherry-picking services – are undesirable”. Please explain in full how and why your proposal does not involve cherry-picking.**

It is made clear in the application that the significantly reduced journey times will generate modal shift from air, and the revenue development work that we have shared with the ORR contains the detail and evidence to support the position. Indeed with these services (at 125mph) proposing journey times almost identical to HS2, then the case made for HS2 applies equally to GNER.

To evaluate applications the ORR applies the ‘not primarily abstractive’ (NPA) test to all open access applications. This ensures 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 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. It also brings further economic benefits through significantly faster journey

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times, modal shift from air to rail, and new employment opportunities. The proposal clearly offers a different type of service from the existing franchise, and can in no way be described as a 'cherry-picking' exercise.

Yours sincerely,



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