

Russell Evans  
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12 February 2014

Dear Russell,

**Industry consultation: Alliance GNER Edinburgh to London service Section 17**

Thank you for your letter addressed to Rachel Gilliland, dated 24<sup>th</sup> January 2014 regarding Alliance Rail Holdings' (Alliance) Section 17 proposal. It provided a series of helpful and constructive comments and questions.

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 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”.*

We are pleased with your comment that First Group welcomes proposals for additional services on the network. We note your concern that not all aspirations can be met even with infrastructure enhancements currently under way or planned for CP5. The ORR has made it clear on many occasions that it can only deal with applications, not aspirations. We have taken account of the likely level of service for the East Coast franchise and Thameslink services for which rolling stock has been ordered. As far as we are aware, funding has not yet been identified for the rolling stock needed to support other aspirations on the ECML.

In paragraph 4 you quite rightly identify that capacity constraints could lead to a situation where an *“an existing franchise service may have to be withdrawn to accommodate an open access proposal”*. Alliance is mindful of the provisions of Para 18 (5) of the Railways Infrastructure (Access and Management) Regulations 2005 (“AMR”), which allows the better use of the infrastructure.

Alliance notes that with CP4 interventions creating further capacity<sup>1</sup> - and work currently being undertaken during CP5 with the ECML Connectivity Fund<sup>2</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.

Alliance believes that with the capacity created by these interventions and with new access contracts containing a greater level of flexibility that it would not be necessary to consider invoking the provisions of Para 18(5) AMR.

We note your concerns about GNER's impact on the East Coast franchise. We hope that the franchise will rise to the challenge that direct competition will bring – as indeed it has done so far with other open access competition. We have announced our proposal so that franchise bidders can take into account the potential impact of GNER services when developing their bids. The ORR's 'not primarily abstractive' (NPA) test is used to assess the impact on the Secretary of State's funds. In his statement on 23<sup>rd</sup> January 2014, Rail Minister Stephen Hammond continued:

*“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”, 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”.*

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

We note your comment that *“This assessment will also need to take into account the level of contribution from access charges from the new service”*. With the new Capacity Charge regime proposed for CP5 the GNER services will pay a significantly higher total access charge than the current open access operators. The business case for this application takes this into account. The overall position of access charges was dealt with (amongst

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<sup>1</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>2</sup> The Secretary of State ... *“seeks further improvement in capacity and reduction in journey times”*.

other things) in the High Court in 2006, and Hull Trains was one of the parties involved along with the ORR and Grand Central.

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.

You will be aware that 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 which is now established case law.

In paragraph 7 you raise your concerns regarding performance. Alliance is investing in brand new class 390 units which have proved to be highly reliable and capable units on the WCML. We will work with the industry to ensure that their introduction and operation minimises disruption. We are also mindful that Network Rail is developing the foundations for a new ECML timetable by reviewing and amending the December 2016 rules. A new set of planning rules and a timetable recast in 2016 should lead to a more robust timetable.

In paragraph 9 you raise your concerns about the deliverability of the infrastructure, rolling stock and timetable based on your own experiences. Alliance will ensure that it develops robust project plans, working with Network Rail and others as necessary through the normal industry mechanisms.

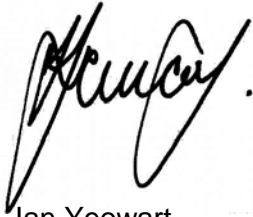
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The Alliance proposal comfortably exceeds the NPA threshold set by the ORR, and as acknowledged by the government, offers a service that will work well for both customers and the public purse.

Yours sincerely,



Ian Yeowart  
Managing Director

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