Department for Transport

From the Permanent Secretary
**Philip Rutnam**

Great Minster House
33 Horseferry Road
London
SW1P 4DR

E-Mail: philip.rutnam@dft.gsi.gov.uk

Web site: www.gov.uk/dft

23 April 2015

**Richard Price**
Chief executive of the Office of Rail and Road
1 Kemble Street
Westminster
London
WC2B 4AN

**FIRST GROUP SECTION 17 APPLICATION – EAST COAST TRAINS LTD**

My officials have been asked to consider the potential impact of this application on the Secretary of State's funds. As such, I attach the Department's analysis of the potential impacts as an Annex to this letter.

The analysis presented here focuses specifically on impacts occurring during the life of the current ICEC franchise and in the 10 years after the end of this franchise. The total impact depends on whether or not the proposed timetable can run in addition to VTEC's proposed services, and if ECTL is able to offer fare competition.

I should add that in the very limited time available it has not been possible to undertake an examination of the impacts this application could have on the VfM of East Coast investments such as IEP and the possible issues posed for future investment.

Please let me know if you require additional information. My officials are able to meet and discuss with yours if you would find that helpful.

I am copying this letter to Rob Plaskitt, Head of Licensing and Regulation at ORR.

Philip Rutnam

**PHILIP RUTNAM**

**ANNEX**

**FIRST GROUP SECTION 17 APPLICATION – EAST COAST TRAINS LTD – DfT EVIDENCE**

## Operational feasibility

First Group has developed a timetable showing its proposed services running alongside the May 2020 service planned by VTEC, (with some modifications). It is based on the assumption that eight Long Distance High Speed (LDHS) paths can be accommodated on the route alongside the TSGN off-peak and peak suburban service.

We understand that the latest Network Rail report on capacity on the ECML 'ECML 2020 Capacity - Timetable Assessment Report' (17/12/2014), found that the only way to fit 8tph LDHS London services on the southern section of the ECML would be if other compromises were made. For instance, the 8tph specification requires that either Stevenage calls are not provided in LDHS services or that further changes to calling patterns between Peterborough and Doncaster are made, leading to reduced connectivity and extended journey time for some LDHS services. The report also found that an 8tph service pattern would probably reduce reliability and that choices would need to be made between freight, regional and long distance passenger services. Therefore, it is possible that the required modifications to other operators' services may not be feasible at all, or if feasible could generate adverse performance impacts.

A further operational consideration relates to the quantum of trains between Northallerton and Newcastle. Work on previous applications has assumed a maximum of three London LDHS paths on this section, to allow sufficient capacity for other services – including freight – based on Network Rail's capacity study. First Group's proposed standard hour pattern identifies paths for additional trains that would increase the number of London services to four in certain hours, however it is not clear that this can be achieved because;

- **First Group's proposed timetable is unable to fit the full freight ITSS[1] schedule alongside its proposed passenger services structure**. As discussed in Network Rail's report it may be possible to re-route freight via the Durham Coast/Stillington, but this may require additional infrastructure enabling works;

- **The proposed timetable is likely to introduce a further performance risk due to additional overtaking moves and the flighting of services**, (that could potentially impact upon platform and termination operations at Darlington and Newcastle). As Network Rail has yet to compare the performance difference between flighted fast Edinburgh services and regular pattern with overtaking moves on the ECML (page 64 of December Report), it is difficult to assess the overall performance risk to First's proposed timetable structure.

For the reasons mentioned above, there is a possibility that – should ORR accept this application – First Group's services would run in place of the planned VTEC services in those hours and hence that the Secretary of State Risk Assumption ("SoSRA") and consequential adverse impacts on SoS funds discussed below would be triggered.

---

[1] The indicative Train Service Specification (ITSS) (version as of September 2013) for the ECML considered in Network Rail's 'ECML 2020 Capacity - Timetable Assessment Report' (17/12/2014) is an aspirational level of service to be achieved on the whole of ECML in the future. The ITSS includes service level descriptions of LDHS London services, non-London LDHS services, inter-regional and local services and freight services for sections along the ECML.

**Impact on DfT funds**

As the position is unclear as to the operability of the First Group timetable we have tested two scenarios of the impact of the First Group application. These are as follows;

1. First Group runs 5 trains a day to Edinburgh in addition to the planned VTEC service, (based on a timetable built on the revised standard hours timetable proposed by First Group);

2. First Group runs 5 trains a day to Edinburgh in place of the planned VTEC service to Edinburgh in those hours, (based on the bid timetable, with VTEC services removed to accommodate the First Group trains while keeping the total number of tph constant).

Only the second of these scenarios would trigger the access rights SoSRA and hence have an impact upon the funds available to the Secretary of State during the VTEC franchise term. However – in both cases – once the current ICEC franchise is ended, the bids for the subsequent franchise would be reduced by almost the full financial loss.

First Group has applied to operate the proposed services from December 2018. However it is not clear that this is feasible because;

- The amount of capacity available on a line depends on the fleet and service pattern operated. The introduction of the Class 800 fleet will increase line capacity on sections with frequent stops due to its faster acceleration. Therefore, it is more likely to be possible to introduce additional services after the full Class 800 fleet has been introduced and utilised in full after the May 2020 timetable change;

- We are not aware that the rolling stock required to operate the service proposed by First Group is currently available. In its track access application First Group proposes the use of new build 125mph rolling stock with performance capabilities comparable to the new Class 800 fleet. Following the ORR's determination on track access rights First Group will need to procure this fleet, which will then need to be built.

For these reasons, it is assumed that services will commence from the May 2020 timetable change date – when the full Class 800 fleet will be in operation – rather than in advance of this date.

**Impact during the franchise term**

As the SoSRA is only triggered if the quantum of VTEC services is reduced to accommodate the proposed First Group services, this section only considers scenario 2 above. The results are shown below, with Table 1 setting out the results in the case that First Group does not offer undercutting fares and Table 2 showing the results if First Group undercuts VTEC fares by 15%;

Table 1: Net impact – franchise term (£m, nominal) First Group Application with reduction in VTEC services, no differential fares

| Option | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | Nominal Sum (Years Shown) | Nominal Sum (Franchise Period) |
|---|---|---|---|---|---|---|---|---|
| Passenger Revenue | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Other Revenue | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cost | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Net | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Premium | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| **Profit or loss** | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

Table 2: Net impact – franchise term (£m, nominal) First Group Application with reduction in VTEC services, differential fares

| Option | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | Nominal Sum (Years Shown) | Nominal Sum (Franchise Period) |
|---|---|---|---|---|---|---|---|---|
| Passenger Revenue | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Other Revenue | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cost | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Net | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Premium | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| **Profit or loss** | - | - | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

In both cases there is a significant reduction in passenger revenue, which is partially mitigated by a reduction in costs as less services are operated by VTEC, (a reduction in costs is shown as a positive number). A decrease in the premia paid to government is shown as a positive number in the tables above. As a result of SoSRA being triggered, the premium paid to the Department is reduced by [redacted] in 2020/21, rising to [redacted] by 2023/24. The total reduction in premia paid over the remainder of the franchise is [redacted]. Note that if ECTL undercuts VTEC fares the level of SoSRA protection will remain the same, but the impact on franchise profit will be greater.

### Impact after the current franchise term

Although in the short term the DfT is only exposed to the decrease in premia required under the SoSRA, in the longer term the value of future franchise bids would be reduced by almost the full financial loss to the ICEC franchise holder, and the reduction in premia set out in Table 3 below would apply. As above a positive premia line represents a reduction in premia payments to the Department. In each scenario the expected change in premia is slightly less than the net change in revenue and costs, as the profit of the ICEC franchise holder is also expected to reduce, (because the profit of the franchise operator is set as a proportion of passenger revenue).

Table 3: Net impact compared to the base for the next franchise term (£m, nominal)

| Option | 2024/25 | 2025/26 | 2026/27 | 2027/28 | 2028/29 | 2029/30 | 2030/31 | 2031/32 | 2032/33 | 2033/34 | Nominal Sum |
|---|---|---|---|---|---|---|---|---|---|---|---|
| First Group Application no reduction in VTEC services – no differential fares | | | | | | | | | | | |
| Total Revenue | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cost | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Premia | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| First Group Application no reduction in VTEC services – with differential fares | | | | | | | | | | | |
| Total Revenue | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cost | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Premia | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| First Group Application with subsequent reduction in VTEC services – no differential fares | | | | | | | | | | | |
| Total Revenue | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cost | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Premia | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| First Group Application with subsequent reduction in VTEC services – with differential fares | | | | | | | | | | | |
| Total Revenue | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Cost | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| Premia | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |

As shown above the estimated impacts vary significantly, depending on whether or not First Group's timetable can be accommodated in addition to VTEC's proposed services and whether or not ECTL is able to undercut the franchise operator's fares. If ECTL's services are additional and they do not offer more competitive fares, then the reduction in premia paid to the Department in the ten years after the current ICEC franchise ends is [redacted]. If on the other hand ECTL's services cannot be accommodated in addition to VTECs proposed services and they are able to offer 15% cheaper fares, then the reduction in premia in the ten years after the current ICEC franchise ends is [redacted]. The fall in premia paid yearly to the Department is [redacted] by 2033/34 in the first case, compared to [redacted] in the latter case.

Given these impacts on the Department's financial position, it is likely that this application would also have some adverse impact on the VfM of East Coast investments such as IEP and the business cases relating to future investment, as the Department has evidenced in relation to previous applications. It is also possible that the proposed timetable would put further pressure on existing infrastructure. For instance, issues relating to power supply north of Newcastle could lead to additional expenditure – which could be substantial – and it is unclear how such expenditure could be covered. However, in the very limited time available we have not attempted to quantify such impacts.