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20 July 2015

Dear David

Thank you for forwarding the letter you have received from the Secretary of State at the Department for Transport (DfT) dated 16 July 2015.

It is disappointing that following a very comprehensive and thorough consultation period on applications that correspondence should continue to come to the ORR in an attempt to influence the ORR Board's decision at the last minute. We are aware that the ORR should '*have regard to any general guidance given by the Secretary of State*' amongst its many other duties, but this letter seeks to go beyond that general guidance and makes very specific recommendations.

We note that the DfT wrote only last week to the ORR regarding our West Coast application. We do not believe that any new ground has been covered in the letter of 16 July that has not previously been raised in correspondence by the DfT.

We also note that in relation to the East Coast Main Line (ECML) the DfT set out its position at the industry hearing and in response to the industry consultation. Again, no additional information has been provided in the latest letter.

The letter identifies that the government's position is set out in the 2012 Command Paper "*Reforming our Railways*". It is important to note that the full title is "*Reforming our Railways: Putting the Customer First*". The customer is not mentioned once in the letter you have received.

The command paper identifies four objectives:

- Securing value for the passenger (through lower fares)
- Dealing with fiscal deficit (by aggressively seeking out savings)
- Supporting economic growth (through continued investment for passengers and freight by providing the industry with the opportunity to invest)
- Delivering our environmental goals (encouraging passengers to use the train rather than the car)

Open access can deliver all these objectives. The downward pressure on fares through competition is well understood and open access often supports economic growth in places that franchised operators ignore – e.g. Hull, Hartlepool and Halifax.

The remainder of this letter deals with the specific points raised by the DfT.

- *“Open access services can also have considerable negative consequences for the taxpayer and railway investment.”*

There is not a shred of evidence to support the claim regarding the impact on the taxpayer. We have asked the DfT to provide evidence but it has never done so. The CMA, in its recently-published discussion document ‘Competition in passenger services in Great Britain’, also suggests that there is little or no evidence to support the claim.

It is worthwhile noting that the DfT has constantly overstated the actual impact on its funds and this issue was noted in the “Study on Regulatory Options on Further Market Opening in Rail Passenger Transport”¹ At page 172 para 6 the report states:

“Overlap between open access and services operated under public service contracts bring up particular issues , not least that of revenue abstraction”.... “in Great Britain there has been open access both regulated (a number of services between London Kings Cross and the North East) and unregulated (on the line to Heathrow). These have been successful in all respects, although it has been claimed (with scant justification in the view of the Consortium) that Kings Cross routes undermined the finances of the franchise holder”.

We must point out again that on the only route where there is open access competition the premium paid to the government has increased every time the franchise has passed to a new operator, despite increased competition from open access. This contradicts the claims made in the letter.

With regards to the impact on railway investment, we note that Directive 2012/34 sets out the member states position in relation to infrastructure. It states under recital 8:

“In order to boost competition in railway service management in terms of improved comfort and the services provided to users, Member States should retain general responsibility for the development of the appropriate railway infrastructure”.

Investment in infrastructure does not grant the DfT or its franchises an exclusive right to operate or to restrict open access services from using the investment. Such a position would be illegal.

Railway cases for investment are normally made on the basis of positive economic benefits, and such investment rarely brings a positive cash return to the treasury. Both open access and franchises can deliver economic benefits, as is recognised by the CMA. There are

¹An independent report for the EU by Eversis and NTU consultants in 2010

means at the DfT's disposal to charge all operators for the use of new infrastructure including Access Options and rebate mechanisms. The DfT has chosen not to use any of these.

Considering the comments in the letter it is ironic that GNWR's application is currently the only proposal that will deliver the benefits of the £250 million infrastructure improvements in the Stafford area, the business case for which was predicated on delivery of two additional Long Distance High Speed paths between London and the North West.

In considering all the current open access applications with the ORR, the DfT ignores the huge associated investment being proposed by the private sector in new rolling stock. This was part of the third objective of the 2012 policy paper. Open access operators are also prepared to invest in infrastructure schemes where the length of access rights can justify it.

- *"In particular they can abstract revenue from franchised train operators, reducing the premia that these operators can pay to Government, and thereby increasing the net contribution to the Railway that taxpayers have to provide."*

The 2012 command paper refers to the need to reduce the overall cost of the railways to the taxpayer, which continues to reduce in real terms, including on the ECML where a higher premium has been bid each time the franchise has changed hands despite the presence of more open access.

We note that the DfT's contribution towards the rail industry stood at £2.6 bn in 2013-14, less than a third of the £8.2 bn paid by passengers in fares. The amount paid by DfT was less than the network grant to Network Rail, which amounted to £3.7 bn (including sums from the Scottish and Welsh governments). Reducing Network Rail's costs is the key to reducing the taxpayer's net contribution to the railway, not restricting competition.

It is also worth pointing out that on 23 January 2014 the Rail Minister stated support for the ORR policy for using the 'Not Primarily Abstractive' (NPA) test as a balance between promoting rail competition and the potential impact on the Secretary of State's funds.

- *"Open access operators pay only marginal track access charges and now also pay lower rates of capacity charges than franchised operators."*

This is because a) they are forced to operate at the margins rather than compete head on with franchises and b) the 2006 High Court ruled that it would be illegal for open access operators to pay a fixed charge for which franchised operators are indemnified against future increases. 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]*.

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Franchised operators and open access operators are also considered to be in different market segments by the ORR as a result of the way in which access to the network is gained.

Open access operators pay charges as determined by the ORR following the PR13 review and industry consultation.

- *“Government does not at this stage support an increase in open access competition, either on the ECML or elsewhere, until or unless there is a fundamental change in the approach to access charging.”*

We have sought to engage with the DfT on this matter. However, we note that it is the DfT who has chosen to restrict its ability to recover costs from open access operators by opting out of Article 12 of Directive 2012/34 and by paying grant via the fixed charge.

Should the charging regime be changed dramatically then so must the way in which open access operators gain access to the network.

- *“Government has committed to a substantial new investment in new Class 800/801 trains for the ECML, and enhancements to the infrastructure, to allow faster and more frequent services. The Government made this investment on the basis that part of the cost of the new trains and enhanced infrastructure would be offset by higher passenger revenue, reducing the net cost to Government.”*

The DfT has not presented a convincing case as to why the investment in the rolling stock would be damaged by any of the ECML open access applications. We note that Virgin Trains East Coast (VTEC) will not have enough class 800/801s to operate all of its proposed services; it also relies on retaining part of the existing fleet of class 91s and Mk 4 coaches. It was also identified at the recent hearing that, as long as VTEC is able to deliver its 6 core services per hour, the Secretary of State’s Risk Assumptions do not provide a guarantee of revenue support, so the franchise premium would not be at risk.

- *“As the Department has previously set out for the East Coast applications, it is important to establish the operational and performance impacts of the services prior to rights being granted, rather than subsequently.”*

Network Rail made such an assessment in its December 2014 report on ECML Capacity for 2020. It suggested further detailed work could be commissioned either before or after access rights were granted. In any case, the nature of the timetable will depend on access rights for other operators – for example GTR and (new) TPE – that have not yet been applied for.

The letter continues that this is also vital in the case of the GNWR application on the WCML, specifically relating to access to London Euston from 2017. It is important to note that GNWR’s application has been made under Section 18 of the Railways Act and is fully

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supported by Network Rail. We note that the DfT has instructed London Midland to seek rights for its services even though its application is **not** supported by Network Rail.

GNWR is part of the industry steering group and working groups looking at capacity at Euston once HS2 enabling works commence. Network Rail recognises that the real constraint at Euston will occur in the morning and evening peaks. GNWR's application is only for services to operate in the off peak and a solution exists for this. In the unlikely event that GNWR's services cannot access Euston we have agreed with Network Rail a robust solution to operate to and from Queen's Park London.

- *"To assist the ORR in its assessment of these applications my officials have provided you with the calculations of the potential impacts these applications would have on the funds available to Government"*

It is worthwhile noting that the DfT has consistently overstated the actual impact of the introduction of open access services. The DfT's estimates are based on modelled figures and despite requests no hard evidence to support these claims has ever been provided.

In support of their applications open access operators have supplied evidence based on data collected after the introduction of new services that demonstrate that open access has abstracted less than forecast on head-to-head flows and generated significantly more than forecast on flows to and from stations off the main route. The CMA has accepted much of this evidence in its discussion document on rail competition based on previous studies carried out by Arup and AECOM.

Yours sincerely



Ian Yeowart
Managing Director