Rob Plaskitt

Head of Access and Licencing

ORR

1 Kemble Street

London

WC2B 4AN

Cc Philip Rutnam

Richard Price

Andrew Murray

3rd June 2015

Dear Rob,

GRAND CENTRAL SECTION 18 APPLICATIOIN- GREAT NORTH WESTERN RAILWAY COMPANY LTD (GNWR) – RESPONSE TO THE DEPARTMENT FOR TRANSPORT

On the 8th May Richard Price received a letter from Phillip Rutnam of the Department for Transport (DfT) in response to the consultation by GNWR on its proposed London to Blackpool service. This letter sets out our response and is made by Alliance on behalf of GNWR. We have copied in the response to Philip Rutnam, Richard Price, and Andrew Murray for completeness.

For clarity, we have responded on each point raised by reference to the paragraphs in the DfT response.

Page 1 Para 2 **Assumptions about DfT funds**

In this paragraph the DfT state: *"The figures can be considered a proxy for the impact on the Department for Transport's funds, once Train Operating Company profits are taken into account"*

On this point we cannot agree for two main reasons; these being the issue of the definition of (a) Public Service Obligations (PSO's) and (b) fact that franchised operators also operate services outside the franchise agreement.

(a) Public Service Obligations

As there are no defined PSO's this calls into question the legality of franchises awarded under as a Public Service Contract (PSC). Many of the services that are in franchise agreements do not meet the definition required under Regulation 1370[1] for PSOs. Because of this the DfT is overstating what it believes the impact will be on its funds. Logically, there is no need to specify franchise services that can be operated on a commercial basis, particularly the franchises that pay a premium.

(b) **Services operating outside Franchise Agreements**

There are train operators who operate services outside the requirements of the franchise agreement. These are commercially operated services. Under Regulation 1370 there is a legal requirement for services to be accounted for separately to avoid claims of illegal state aid. The European case of *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH* is relevant here. The lack of clear definition of which services operate as a PSO and those that do not is a significant commercial risk for the operators and the DfT.

Page 1 Para 3 **Timescales**

The DfT state: "*I should add that the limited time available we have been only*

[1] Regulation (EC) No 1370/2007 of the European Parliament and of the Council of 23 October 2007 on public passenger transport services by rail and by road and repealing Council Regulations (EEC) Nos 1191/69 and 1107/70

able to produce indicative estimates"

The DfT was advised about our intention to progress a Blackpool application in March this year. In addition given that this application is for a reduced subset of services from the four previous applications, we believe that the DfT has had sufficient time in order to assess the impact on the Secretary of State's funds. It should be noted that we did discuss with the DfT the consultation timescale on this application and no issues were raised.

Page 3 Para 1 **The revised methodology**

The DfT's analysis is based on applying Blackpool's percentage of the combined Blackpool/Leeds total revenue to the combined abstracted revenue to obtain an estimate of the revenue abstracted by a standalone Blackpool service. Implicitly this assumes that the Generation:Abstraction ratio is the same on both routes.

The analysis carried out by AECOM (and in MOIRA) shows that Blackpool is more generative than Leeds. This means that the DfT analysis will overstate the revenue abstraction.

Page 3 Para 3 **Operating cost savings**

The DfT state: "*as the service is not expected to displace any franchised operator services - no operating cost savings are expected".* On this issue we note that this is the DfT's choice as it could allow a franchised service to be operated by an open access operator, in which case there would be an operational saving.

In addition we are also aware that as part of the HS2 works at Euston the DfT identified it requires 8 additional Pendolino cars to cope with the current demand. The DfT could mitigate some of this cost if it took into account the GNWR services in its assessment. If the GNWR services are approved there is a potential direct cost saving to the Department of around £25m. The rolling stock to be procured by GNWR requires no public funding, unlike the 8 additional

Pendolinos required by the DfT.

Page 3 Para 4 The DfT acknowledges that the *"figures presented here are estimates of the impacts this application could have on existing franchised operators; not the Departments funds. However- given that train operating companies usually retain only a small fraction of revenue as profit – these numbers are indicative of the potential impacts on the Departments funds"".* On this point we do not agree that the assessment is representative of the impact on the DfT's funds. It is disappointing that despite being given advance notification of our plans for Blackpool that the DfT has presented unrepresentative analysis. There is no actual evidence put to the ORR that there will be any impact on the DfT funds. The ORR is reminded that the DfT has a poor record on assessing (and overstating) the financial impact on its funds in previous applications. This was noted by the EU in the 'Study on Regulatory Options on Further Market Opening in Rail Passenger Transport'[2] 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 King's 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 King's Cross routes undermined the finances of the franchise holder".

Despite this being identified in 2010, the DfT has again provided "scant justification" of the impact on its funds.

We also note with some concern that the DfT has again overstated its position by quoting the impact to include operator profits. Franchised operator profits (and cost of making sales) need to be netted off figures supplied by the DfT

Page 4 **Revenue growth assumptions used**

[2] An independent report for the EU by Eversis and NTU consultants in 2010

The DfT has assumed that fares will rise by RPI+1% each year. The new government has promised to "*keep commuter rail fares frozen in real terms for the whole of the next Parliament – regulated fares will only be able to rise by Retail Price Inflation, and train operating companies will not have any flexibility to raise ticket prices above this*"[3]. The DfT's figures require reworking to reflect this.

Evidence from the ECML shows that ridership and revenue has grown faster on flows where there is competition than on flows without competition. This benefits both the incumbent and the new operator and reduces net revenue abstraction. In general, competition stimulates the incumbent operator to improve their offer leading to revenue benefits and a reduction in any potential impact on the Secretary of State's funds. We have previously shared our detailed findings and evidence with the DfT.

Alliance notes the restrictions that are placed on open access operations by the DfT and through the ORR's MoC policy are driven by the need to have regard to the Secretary of State's funds. This duty was introduced in 1994 in order to protect the taxpayers position in what was a declining industry. Privatisation has not delivered the full benefits that competition can bring because of these restrictions. It is worth reflecting on the intention of the ORR and the DfT at the time of privatisation.

The ORR stated *"The government's objectives were set out in "Gaining Access to the Railway Network" published in 1993. This document explains that it is the government's intention that on-track competition in the first generation of franchises will be moderated, but only to the extent necessary to ensure the successful transfer of British Rail's passenger*

[3] Conservative manifesto 2015

ALLIANCE RAIL HOLDINGS

services to the private sector [4] *and to ensure that taxpayers receive value for money for subsidising socially necessary services"*[5].

In addition, the same policy consultation notes, at page 17: "*The longer term objective is one of fully open access*". We look forward to this day and would look to work with the ORR and the DfT to achieve what would be a very beneficial outcome for consumers and the taxpayer.

Yours sincerely

Ian Yeowart

---

4 These are the author's italics

[5] Competition for Railway Passenger Services 1994 para 1.8 page 11.