ATOC

ASSOCIATION *of* TRAIN OPERATING COMPANIES

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Dear Joe

CONSULTATION ON THE POTENTIAL FOR INCREASED ON-RAIL COMPETITION

Thank you for the opportunity to comment on your consultation on the potential for increased on-rail competition.

As you will appreciate, there is a considerable range of views across ATOC members about this consultation which reflect the range of experiences, both positive and negative, that members have had with open access services. In this response we have attempted to identify a number of strategic issues that the consultation raises, such as the future of access charging, for further discussion with you as you consider the next steps in this consultation. As with other consultations, individual operators will respond with their own views on the important matters identified in the consultation.

As was noted during the recent ORR workshop, our members are in principle supportive of greater competition. However we believe that its application must be considered within the wider context of ongoing industry reform – both the reform of franchising and Network Rail devolution – and the need to focus industry efforts and resources on those issues that will deliver the best and most sustainable value for money outcomes. In particular we would make the following headline points:

- **The most significant monopolistic situation in the industry exists in the provision of infrastructure.** Not surprisingly it is also the part of the industry where the potential for cost reduction is greatest. Franchisees have to bid for the right to operate trains in hard-fought commercial contracts. They are not given the role as of right. Furthermore, they are backed by companies with a commercial focus keen to drive efficiency during franchise operation: the significant savings achieved by TOCs in recent years in response to the recession is testament to this. In this context we believe there needs to be a more even-handed approach to competition in the rail sector, with more emphasis on the part of the industry with the greatest competitive deficit i.e. the infrastructure manager.

- **Achieving value for money means considering the impact on the commercial value of franchises and the net cost to the taxpayer.** Increasing the scope of open access competition within the existing regime – particularly after franchises have been let and where operators will have limited ability to respond in terms of altering their own services – will have significant implications for franchise revenues and, by extension, the net call on the taxpayer. As noted in the consultation, the latter will almost certainly rise, even under conditions where open access operators pay a share of FTACs or face some value-based access charge.

- **There needs to be early certainty on policy toward on rail competition otherwise it will reduce the value for money to the taxpayer from upcoming franchise bids.** This a particular concern for the forthcoming Inter City West Coast, but also the other franchise re-lets that follow including East Coast. Any uncertainty is unwelcome, particularly given the strategic importance of the two intercity franchises; in this context and in the current economic climate we can understand the concern of the DfT over policy proposals that may affect franchise premia. While we note ORR comments at the workshop that a mixed policy approach could be pursued i.e. retaining the NPA test for the Inter City West Coast franchise but possibly moving to a wider cost-benefit approach for others, it is nonetheless crucial that ORR reaches firm conclusions in this area quickly.

- **Access charging must be reformed to create a more level playing field between franchised and open access operators.** There is recognition in the consultation that access charges for open access operators are too low when a cost benefit test rather than a 'not primarily abstractive' test is applied to new services. Giving effect to a policy which aims to make policy makers indifferent between a franchised operator and an open access operator presents a huge challenge. It is nonetheless worth exploring whether this is practicable and ATOC would be happy to engage in such work.

- **We are disappointed that the consultation did not consider long term concessions on some routes.** For some services not requiring subsidy, reform could be based on the creation of 'licensed operators' or 'perpetual franchises' as an alternative to existing franchises, as we proposed in March this year. These could be structured around a 'bundle' of train paths licensed on a long term basis with a light touch regulatory oversight i.e. closer to the sort of model originally envisaged under the 1993 Act. This bundle of paths could be auctioned in a competition. This sort of model would encourage a much more commercial and innovative approach with a strong focus on growing revenue and reducing costs.

- **The industry needs to identify and prioritise reforms that deliver the best value for money outcomes.** Given the very significant industry reform agenda underway in the run up to PR13 and the limited resources available to deliver it, this means focussing on ensuring Network Rail devolution is fully implemented and followed up with moves to concessions, driving greater contestability in infrastructure and reforming franchises. Further on-rail competition may be worth pursuing but it is not a substitute for these reforms. Similarly it needs to be based on sound evidence that it will drive passengers' and funders' desired outcomes on both industry performance and affordability.

Comments on specific aspects of the consultation

- Franchised TOCs are currently heavily constrained in their ability to vary their timetables and outputs in response to increased open access competition, for example by reducing, retiming or withdrawing services completely where these may be unprofitable. Indeed at present this is next to impossible, not least because franchisees are tied to leasing rolling stock for the entire duration of the franchise term which leaves very little room to be flexible in how assets are deployed and therefore in managing costs. If further open access competition is to be pursued, it is imperative that franchised operators are able to compete on equal terms. Under certain circumstances this could potentially be achieved through a move towards a much more flexible concept of 'licensed operators' (see above) although this would require broader reform to the shape of franchises and would need to be aligned with funders' emerging requirements.

- The consultation significantly underplays the extent of existing competition both on-rail between franchised and open access operators and between modes. Several rail flows (e.g. London-Birmingham) are already very well-contested amongst operators – not just on the basis of price but also in terms of speed, frequency and service quality – and this competition has brought important passenger benefits. Similarly many operators, particularly those on intercity routes, compete primarily with other modes of transport (air, coach and private car) and even with alternative potential consumer expenditure choices. In this context they have tended to optimise their service provision to best meet the challenge of these competitors.

- Open access competition has been successful in challenging Network Rail to create additional capacity from fixed infrastructure. It should not however require open access operators to do this; PR13 is a good opportunity to create additional capacity through behaviour changing incentives that flow through the whole of Network Rail.

- We have reservations regarding the evidence and assumptions underpinning the analysis undertaken for ORR by MVA/ITS. In particular:

    - We do not believe the evidence is sufficient to conclude that franchised TOC costs are demonstrably too high; analysis from the McNulty Study indicates that costs for GB franchised operators are in fact at or below the level of European counterparts. However, we recognise that open access operators have in some cases been able to establish businesses with a lower cost base than franchised operators, in part due to the opportunity afforded to set up from scratch. It is possible unit costs might rise if open access operators took on a much greater role, but this may depend on the means by which this is introduced;
    - Franchised operators face a number of constraints on their ability to reduce or restrict the growth of some important costs, particularly wages. In addition the very detailed franchise specifications favoured in recent years have had the effect of increasing costs over and above the levels that a more flexible and commercially-focussed operator could achieve, be they franchised or open access. These constraints – and their implications for TOC cost structures – therefore need to be properly understood. It is far from clear that simply facilitating further on-rail competition would, of itself, unlock the sorts of savings suggested compared to other reforms, such as longer franchises, which would allow TOCs to take a much more strategic role in areas such as labour productivity.

  In this context we would suggest that further engagement with train operators – both franchised and open access – to test the evidence and assumptions in the MVA/ITS work is essential.

- In addition, there are a number of wider aspects of open access operation that the consultation does not address directly. For example if open access did become more important what would be the approach to fares regulation, provision of 'PSO' services and the fulfilment of funders' Section 30 duties? We believe a 'licensed operator' model would provide a good starting point here.

I hope these comments help to inform your thinking and would be happy to discuss these issues further with you and colleagues if that would be helpful.

Yours sincerely

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Director, Policy & Operations