Responses to consultation on ORR's draft guidance on the Economic Equilibrium Test

Consultation on ORR's draft guidance on the Economic Equilibrium Test (EET)

Arriva UK Trains response

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Arriva is one of the leading providers of passenger transport in Europe, employing more than 60,000 people and delivering over 2 billion passenger journeys across 14 European countries each year. Arriva runs a range of transport services including trains, buses, trams, coaches, waterbuses and non-emergency passenger transport. It is part of Deutsche Bahn (DB) and is responsible for DB's regional passenger transport services outside Germany.

Arriva is a major train operator in the UK, operating rural commuter lines through to long distance and inter-urban services. Arriva's rail companies include Northern, CrossCountry, Chiltern, Arriva Rail London ("the Overground") and open access operator Grand Central. Arriva also provides rail maintenance services via our Arriva TrainCare business. Arriva's UK Bus division provides regional services across the north east, north west and south east of England, Yorkshire, the Midlands and Wales, offering a wide range of rural, urban and inter-urban bus services with one of the industry leading bus satisfaction scores.

Executive summary

Arriva UK Trains (AUKT) welcomes the opportunity to provide feedback on ORR's draft Guidance for the implementation of the Economic Equilibrium Test (EET). We note that the Guidance is needed to provide clarity for the effective implementation of EU Regulation 2018/1795, which came into force on 1st January 2019. Although member states are only required to apply the EET, in the appropriate circumstances, to services commencing on or after 12th December 2020 we note that the proposal for a minimum lead time of 18 months gives some urgency to the Guidance being finalised.

Since AUKT's portfolio of businesses includes government-specified franchises, a concession and an open access operator (Grand Central) our response reflects the interests of all those companies. We have taken into account the possibility of franchise revenue being impacted by an application from another Train Operating Company (TOC) to run commercial services outside the framework of a Public Service Contract (PSC) as well as the impact of Grand Central on other TOCs – whether from another owning group or those of AUKT - if it were to

apply for rights to operate new services from December 2020 onwards. We consider that further thought may be needed to provide sufficient assurance to both applicants and those impacted by new services.

Whilst much of the Guidance uses the terminology and requirements of Regulation 2018/1795, and is therefore not for debate, AUKT has identified a number of areas where the ORR's Guidance adopts its own definitions and has indicated a specific approach to the EET and the relevant assessment criteria. In this response we focus on these areas.

AUKT would like to see:

- A reduction in the proposed lead time between advising the ORR of a proposed new service from the proposed 18 months to no more than 14 months. This still allows time for the EET to be conducted before the Timetable Priority Date, when access proposals must be submitted to Network Rail.

- A more level playing field between Open Access Operators (OAOs) and TOCs applying to operate commercial services that were not defined in the Train Service Requirement (TSR) – or its equivalent, such as a Service Level Agreement - at the start of the PSC.

- Formal acknowledgment that an application by a franchisee (or other PSC operator) to operate additional services outside the TSR, where no subsidy is sought or offered, are commercial services and will be required to submit to the EET if requested by one of the allowed entities. AUKT notes that, even with this acknowledgement, it is easier for a PSC operator to be granted rights to operate additional commercial services than for an OAO unless the Not Primarily Abstractive (NPA) Test is also applied regardless of any request to apply the EET.

- Greater clarity about the mix of Public Service Obligations (PSO) and commercial services included in a PSC, especially when the franchise is paying a substantial premium. This will help to determine whether a premium-paying franchise really qualifies as a PSC or not for the purposes of applying the EET.

- A common definition of 'substantial modification' of existing services between the EET and that prescribed in the ORR's Infrastructure Cost Charge (ICC) implementation proposals, which are also currently out for consultation.

- A modest relaxation of the definition of 'substantial modification' as described in our response to the ICC consultation and repeated here.

- In the absence of any rigid criteria in the EET for assessing the financial impact on a PSC operator or the competent authority that awarded the contract, a range of values that might be considered to cause the applicant to pass the EET.

Due to the interdependencies between the two, we ask that our response to this consultation is considered alongside that of the implementation of the Infrastructure Cost Charge (ICC), especially with regard to the application of the NPA test.

Conditions for the Economic Equilibrium Test to apply

We agree with the statement that the EET should apply to 'new rail passenger services', including commercial services that are provided by PSC operators. On this basis we consider it to be necessary for the relevant competent authorities (primarily DfT) to confirm the commercial services that are operated by public service contract (PSC) operators.

Distinction between open access services and open access operators

In paragraph 3.2 of the draft Guidance the ORR has equated open access *services* (referred to in the Regulation) with open access *operators.* AUKT has significant concerns about this. Recital 6 of the Regulation provides clarification that the EET can also be requested for *" … commercial services provided by the same operator that carries out the public service contract."* For example, Virgin West Coast is currently consulting on its proposal to operate five additional return services a day between London Euston and Liverpool Lime Street. The franchise is currently under a directly awarded contract and these services are not included in any published train service requirement (TSR), and not identified as PSOs. We believe this qualifies the new trains as open access (or commercial) services as they are outside the requirements of the PSC. However, Virgin West Coast would not normally be considered to be an open access operator (OAO).

In the example above, the new open access *service* at the very least impacts West Midlands Trains' PSC. This means that - if this were for a service start in December 2020 – the TOC could request an EET to assess the impact on its franchise. Under the ORR's draft Guidance this protection would not be provided as Virgin West Coast is not itself classified as an open access *operator*.

The key issue here for AUKT is the competitive advantage the draft Guidance could give a PSC operator over an OAO when making an application for rights for commercial services, both in terms of timescales – as there would be no need for an 18 month lead time – and in potential unfair competition, either by blocking access or by claiming PSC protection. Other

PSC operators would have no recourse to the EET for protection and OAOs would potentially be assessed on their impact on commercial services, rather than PSCs.

Clarification of Public Service Contracts (PSC)

Paragraph 1.1 of the draft Guidance rightly identifies that a PSC in Great Britain[1] is usually a franchise or concession agreement. However, the Guidance then goes on to assume that a franchise is necessarily a PSC. We believe this may not always be the case. EU Regulation 1370/2007 defines a PSC as follows:

> **Public Service Contract** means
>
> one or more legally binding acts confirming the agreement between a competent authority and a public service operator to entrust to that public service operator the management and operation of public passenger transport services subject to public service obligations;

This definition makes it clear that a PSC must be subject to public service obligations (PSO). Article 4 of the Regulation requires that a PSC clearly sets out the PSOs, which are defined as follows:

> **Public Service Obligation** means
>
> a requirement defined or determined by a competent authority in order to ensure public passenger transport services in the general interest that an operator, if it were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions without reward;

Article 2a of Regulation 1370 does allow for PSCs to comprise a mix of non-cost-covering and commercial services. AUKT recognises this point and acknowledges that its own franchises reflect this. However, Article 2a continues:

"When laying down those specifications [for PSOs] and the scope of their application, the competent authority shall duly respect the principle of proportionality, in accordance with Union law."

We would therefore not expect a PSC to include, for example, just 5 PSO services and 95 commercial services. The clear implication is that, if all the services in a franchise would be offered commercially without a specification by a competent authority, it cannot be considered a PSC.

The only way this can be tested properly, for the purposes of the EET, is that the information provided by a competent authority or public service operator requesting the EET must

[1] The Guidance says UK, but Northern Ireland is definitely a special case and does not have franchises.

include a clear statement of the PSOs included in the affected PSC. AUKT asks the ORR to include this point in its Guidance, particularly in the 'Information Requirements' section.

Substantial Modifications

Regulation 2018/1975 requires the ORR to carry out an EET, if requested, on applications for 'substantial modifications' to services as well as entirely new services. This is set out in Article 3(1) of the Regulation. However, Recital 7 gives the ORR discretion regarding the definition of what constitutes 'substantial' in this respect.

AUKT is disappointed that the ORR has proposed, in para 1.5 of its draft Guidance, to define **any** increase in frequency or the number of stops as substantial modifications. It is then hard to see why a track access application would be needed at all for modifications that were not 'substantial', except for contract renewal or extension. We propose that a higher – but still modest - level of change should be necessary for the modification to be considered as substantial. Our proposed definition is set out in the box below.

Proposed criteria for service modification to be considered 'substantial':

- More than one additional train in each direction per day is proposed for each service group (assuming a baseline is set at the start of CP6)
- The additional train(s) does not take the average interval between the first and last train to less than two hours (often deemed the optimum frequency for traditional open access)
- Any additional train does not arrive or depart at a London terminal during the relevant peak period (morning for arrivals, evening for departures)
- Any additional station calls proposed are at a station that has been open for more than a year (at the time of application) and for which the existing operator does not currently have any rights
- The overall number of calls at each station for which the operator has existing rights does not increase by more than one per direction per day.

We note that the term 'substantial modification' has also been used in proposals for implementing the Infrastructure Cost Charge (ICC). It is essential that the definitions are consistent between the two separate uses.

Approach to Assessing the Impact on Public Service Contracts

When considering the financial impact on a PSC, we agree with the proposals that the application of the EET should *"reflect the basis on which the PSC was awarded"* and will consider *"both the PSC operator's expectations of financial performance at the time it bid for the PSC as well as actual performance"*. We believe that this provides the most appropriate position from which to review the impact of any proposed new service, ensuring any factors that a PSC bidder was aware of at the time their bid was prepared are taken into account. We stress that the application of the EET should only consider the impact of the proposed

new services, and should not take account of other factors that have influenced the PSC operator's actual financial performance.

The impact on economic equilibrium

AUKT acknowledges that, in assessing the impact on a PSC, *"predetermined thresholds or specific criteria may be applied but not strictly or in isolation from other criteria"*. We also accept that the ORR should consider each application on a case by case basis.

Notwithstanding these points, AUKT believes it would be helpful, both for those seeking to operate new open access services and for those requesting an EET, if a range of values – rather than specific thresholds – were included in the Guidance. The absence of any calibration or benchmarks to assess the extent of the impact on PSC service profitability, or the net cost for the competent authority, creates a significant level of uncertainty for all parties. We are disappointed to note that, in 4.11, this approach seems to have been specifically ruled out.

We also note the Regulation requirement that the EET should consider the PSC as a whole when assessing any financial impact. In line with our concerns expressed earlier about which services are actually part of each PSC, AUKT asks that the Guidance makes clear that any services not covered by the original contract are excluded from the assessment. This is to avoid the situation where a PSC operator is also running commercial services that are not part of the contract and it is these commercial services that are mainly impacted by the new open access service. Protecting such services is not the purpose of the EET.

Paragraph 4.11 purports to deal with assessing any change in profitability of services operated under a PSC, as required by the Regulation. However, the same paragraph states that the ORR will *"benchmark [its] results with reference to the rates of return earned by the PSC operator".* There is also reference to comparing *"returns earned by other PSC operators"*.

We believe these references are confusing. Rates of return refer specifically to investment and are not the same as profit margins. AUKT asks the ORR to clarify whether it will test and compare investment rates of return, profit margins or both, noting that paragraph 4.6 suggests that a number of different measures should be taken into account. Even if thresholds or ranges are not defined, we believe it is essential that the same financial measures are considered in the application of the EET in each case. In particular, it would be helpful to know on what basis profitability will be assessed: AUKT suggests this should use EBIT in all cases.

Interaction with the Not Primarily Abstractive (NPA) test

Although AUKT initially considered that the EET ought to replace the NPA test entirely, after further consideration we now agree with the ORR that the NPA test should remain as part of the decision-making process when considering applications for new open access services. We therefore expect that the NPA test should also be applied to any application to operate a new commercial service by a PSC operator. This provides a modicum of protection for OAOs against potential unfair competition from any source. As noted above, the EET is only designed to protect funders and operators of PSCs.

AUKT also welcomes the ORR's proposals to change the way the NPA test is applied. We have responded in detail on this subject in our separate response to the consultation on the implementation of the Infrastructure Cost Charge for OAOs.

AUKT also accepts that it is sensible to use the results of the NPA test, where applicable, to provide information for the EET. We would welcome any changes that give greater emphasis to the benefits arising from a new service, whether for funders, customers or as wider economic benefits.

Impact on Competent Authority

In considering the impact on the net cost for the competent authority, thought should be given to the changes to the PSC that the competent authority could make and the associated recommendations provided in this area by ORR. The value of access charge mark ups to be paid by the new Operator should be considered.

Furthermore, clarification is required regarding the process by which the value of any existing exclusive rights would be judged, and exactly what constitutes "exclusive rights" in this context.

Procedure and Timescales

The requirement of Regulation 2018/1795 is for the ORR to make a decision on the EET before the deadline for receipt of requests for capacity. We take this to mean the Priority Date for timetable bids as defined in Part D of the Network Code, 40 weeks ('D-40') before the relevant timetable comes into operation. Article 9 requires the ORR to commence work on the EET, where requested, at least six weeks before the Priority Date, in other words at D-46.

Directive 2012/34 11(2) allows one month after receipt of a request for an EET for the ORR to seek and obtain further information, as necessary, from both the applicant and the

requesting body. The ORR's draft Guidance proposes that an entity with the right to request an EET must do so within one month of receiving information about a proposed application for new passenger services. This suggests that an application must be submitted by D-55 for it to meet the ORR timescales. Coincidentally this is the date at which an applicant should declare to Network Rail its Notification of Significant Change, although this is not actually mandatory under the current Network Code provisions.

AUKT would suggest that, to allow approximately a month's leeway in the process, the applicant's form should be submitted to the ORR no later than D-60 when applying for rights to operate a new passenger service. This equates to around 14 months, some 4 months less than the ORR proposes. Although 18 months may be a more realistic timescale for starting a new service, there are significant commercial risks to an applicant in making its application public too early in the process. We believe our proposal for 14 months is a reasonable compromise, bearing in mind that a new OAO may not wish to commence operations exactly on a bi-annual timetable change date.

AUKT has significant reservations about even a 14 month lead time when the application is for a change, rather than a new service, provided this is a 'substantial modification'. This appears to go against the aspirations of many in the industry, including Network Rail, who would like to see planning timescales reduced. We are also concerned that OAOs seeking changes will be disadvantaged when compared with Public Service Contract operators doing the same. This is already an issue for OAOs waiting for the NPA test to be carried out and would be significantly exacerbated by extending the lead time to 18 months.

We urge the ORR to consider a shorter timescale for the EET in these circumstances. One approach would be to base the test schedule on STP rather than LTP timescales, although we accept this may need further thought in order to comply with the Regulation.

Conclusion

To ensure the introduction of the EET is managed appropriately there are a number of areas, as outlined above, that require further thought and clarification. We consider this to be in the interests of all parties that may be involved in the application of new rail passenger services.

We would be happy to discuss any of these points with you in more detail.

Department for Transport

DAN MOORE,

DIRECTOR,

DEPARTMENT FOR TRANSPORT

Web Site: www.dft.gov.uk

25 January 2019

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Dear John,

ORR's consultations on Open Access infrastructure cost charge implementation and monitoring policy, and guidance on the Economic Equilibrium Test

Thank you for the opportunity to respond to the ORR's consultations in relation to open access. We have greatly appreciated the highly constructive engagement between the ORR and the Department for Transport (DfT) to date throughout PR18, including on open access issues; we have also very much welcomed the engagement with the Competition and Markets Authority (CMA) on this issue, whose work in this area has been very helpful. Across this work, we have focussed on how to deliver passenger benefits obtained from open access, whilst recognising the implications for taxpayers and their considerable investment in improving the railway for passenger and freight users. This will be a theme of this response.

In responding to this consultation, we first set out our overall position on open access, before responding to the specific issues raised in the ORR's consultations. Separate to these consultations, we consider it continues to be critical, as reflected in the ORR's existing access policy and in the Secretary of State's statutory guidance to the ORR, for the ORR to take full account of all the punctuality, reliability, and capacity implications of new open access, with a view to ensuring that granted rights do not detrimentally impact on these vital issues.

Overall our response sets out our view of the importance of the ORR striking an appropriate balance between its statutory duties, most particularly to safeguard taxpayers and their investment in the railway. We have highlighted in our response where we consider a more appropriate and sustainable balance could be taken. In particular, we consider it to be absolutely critical that the ORR preserves appropriate discretion in its policy to ensure that the interests of taxpayers are fully reflected in the particular circumstances of any application.

Open access services and the infrastructure cost charge (ICC)

The Government is committed to placing passengers and freight users at the heart of rail.[1] We therefore support open access in appropriate circumstances where it complements the competitive franchising system to develop new markets and where it provides innovation and benefits for passengers.

As the ORR will appreciate, the Government already plays a key role in supporting competition and innovation in rail. The competition obtained through the franchise system has been vital to provide real benefits to passengers through new, improved, faster and more frequent services, as well as broad improvements to passengers' experience. Additionally, record levels of Government investment has been, and will continue to be, a vital means of improving outcomes for passengers. The major £47.9bn investment programme for CP6, which we have closely worked with the ORR to develop, is focussed on improving the things that matter most to passengers – a more reliable railway with high levels of safety.

We strongly welcome the ORR's clear recognition through the Final Determination of the need to ensure an appropriate charging regime for open access, which recognises the taxpayer implications. We therefore welcome both the principle and aspects of the ORR's consultation on the implementation of the ICC.

The introduction of the ICC is a real opportunity to move forward and ease the long-standing concerns for taxpayers funds around the financial contribution open access services currently make towards the network (which we do not consider are fully addressed through the 'not primarily abstractive' test). We are keen to ensure that the ICC is an enduring and sustainable test, something that is effective and serves its purpose. If the ICC serves its purpose into the medium and long term.

We do have material concerns that aspects of the draft guidance and the options for thresholds consulted on do not strike the appropriate balance between facilitating innovative open access and fully reflecting the implications for taxpayers and the vital role they play in investing to secure a better performing railway for passengers; as a result it does not realise the full opportunities for reform. We have significant concerns that these thresholds may mean that the ICC is essentially theoretical, with its application being only in very limited circumstances, with consequent impacts for taxpayers and the efficient use of the network generally. This could prevent the policy from achieving the objectives that the ORR has stated. We therefore consider that a greater weight should be placed on the ORR's duties in the following areas as it finalises its proposals in this area:

- **To have regard to the funds available to the Secretary of State for the purposes of his functions in relation to railways and railway services**: These taxpayer funds and the investment they provide are clearly critical to improve services for passengers and freight users. Moreover, as the ORR will appreciate and as it recognised during PR18, these funds are limited, particularly following the reclassification of Network Rail; this means that should additional costs be imposed on Network Rail as a result of additional open access, these would be at the cost of other items currently provided for within Network Rail's plans for CP6 and at the expense of rail users.

[1] This response relates to passenger open access only. The Government strongly supports the system of open access for freight which meets the particular needs and requirements of that very important sector.

- **To have regard, in particular, to the interests, in securing value for money …. of the persons who make available the resources and other funds**: Open access operators can result in the business cases for taxpayer investment to improve the railway being negatively impacted, reducing both value for money and the likelihood of such investments being made. We would be happy to provide further specific information on that issue if that would be helpful.[2] As well as the specific benefits set out in our business cases the Department, as funder, more generally secures benefits through the exercise of its levers over service design which are provided via franchise agreements. In this context, allocation of rights to open access operators can restrict funder opportunities to change train service patterns to secure maximum benefits and value for money, which we also consider is an important issue in relation to this duty.
- **To have regard to any general guidance given to it by the Secretary of State about railway services or other matters relating to railways:** In this case, the guidance issued by the Secretary of State in July 2017, including the reference to the Government being supportive of open access "*in particular circumstances where these do not significantly impact on affordability or the value for money from public investment*"[3]

We note that these factors have been considered in the draft guidance. However, our view is that, in some important material respects, they should be **afforded significantly greater weight** in the calculation of appropriate thresholds and in allowing for appropriate discretion in certain circumstances[4]. We consider this issue further in the response to the specific consultation questions.

We also note that this consultation results in the implementation of a new charge and as such we cannot know for certain how it will work whilst or what its effects will be in practice. We have made suggestions as to the Department's thoughts in response to the consultation questions specifically. However we consider that there would be real benefits in the ORR trailing the suggestions we make (e.g. in relation to thresholds) for a defined period of time, such as two years, to see how the definitions/thresholds would apply to open access applications and the implementation of the ICC in practice.

The economic equilibrium test

Alongside the consultation for the implementation of the ICC the ORR has also issued draft guidance consulting on the economic equilibrium test (EET). The EET seeks to explicitly balance the legitimate interests of current operators performing a public service contract (and competent authorities, such as the DfT), on the one hand, with the wider benefits of open access on the other.

[2] Given the commercial sensitivity of some of this information, we would welcome the opportunity to discuss how such information could be shared in confidence should the ORR wish to consider it.

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/629698/guidance-to-the-office-of-rail-and-road.pdf. (Paragraph 19). We also note the guidance issued by Scottish Ministers to the ORR, to which the ORR must also have regard, which also notes: "*We are therefore of the view that protecting the investment made by us and others in rail should be regarded as a key consideration and priority in the development and application of policies on track access rights and charging, and on rail competition"*

[4] Also bearing in mind the ORR's statutory duty to promote the use of the railway network for passengers and goods and the development of the network to the greatest extent it considers economically practicable.

The Government strongly supports the introduction of this test and believes that it will provide an additional necessary foundation for considering open access applications, helping to ensure that the passenger benefits provided by the competition for public service contracts are provided. We welcome the ORR's proposed guidance in this regard, with some suggested points for consideration highlighted below.

Open access monitoring policy

We note the ORR's intention to publish a policy document regarding its approach to monitoring open access; we can see the merit in it doing so and welcome the opportunity to work with the ORR on the role of open access in the current Williams Rail Review. However, we are concerned that the document does not currently fully reflect the well-understood implications for taxpayers of greater open access. Moreover, we have concerns that the document, by focussing on growing open access as an objective, rather than supporting competition generally through addressing unlawful anti-competitive behaviour, could have unintended consequences. In particular, we consider that it is vital that franchised operators are not chilled from being able to effectively and legitimately respond to open access operators, which would reduce competition overall, something that we currently consider to be a risk. We would further consider that there should be no chilling effect for other potential service models which may emerge from the recommendations of the Williams Rail Review. The Williams Review is a root-and-branch examination of the industry's structures and models, which could result in major reforms to how services are delivered across the network and we consider that appropriate flexibility should be preserved in relation to open access models to facilitate reform. We note the further work that the ORR is planning in this area and very much look forward to working with the ORR on the deliverables it refers to in the document to maximise the opportunities and reduce the potential risks.

Responses to consultation questions:

Question 2.1: Do you have views on our proposal to add ICC income to revenue generated in the NPA test when assessing new (or substantially modified) interurban open access services?

We understand the ORR's clear preference to incorporate the ICC into the NPA test calculations. **However, it is our strong view that Option 2, rather than the ORR's proposed Option 1, is both more appropriate and better reflects the balance of the ORR's statutory duties**. In making this representation, we note that the ORR itself considers that option 2 "*arguably has a clearer rationale than Option 1*" and note the position of Virgin/Stagecoach in the preceding consultation that adding the ICC revenue was "illogical" as it does not constitute additional revenue. We similarly cannot see a rational basis for the addition of the ICC to revenue generated. More generally, the ORR's acknowledgement that this option "*would likely to have a greater negative impact on funders*" seems to be afforded relatively limited weight in the development of the options. We are certainly unable from the description provided in the consultation document to be clear how the ORR, consistent with its statutory duties, has balanced its statutory duties in this regard.

We therefore consider that should the NPA test be amended, that greater weight should be afforded to the impact on taxpayers and that Option 2 would be a more appropriate approach.

Question 3.1: Do you agree that the substantial modification definition is appropriate for determining if a modified service proposed by an existing operator is in scope to pay an ICC?

DfT strongly agrees with the ORR's position regarding the definition of existing open access operators – that is operators that had access agreements approved before 26 November 2015. We also broadly agree that the definition for substantial modification should be consistent with the ORR's proposed guidance for the EET.

DfT broadly supports the ORR's definition for a 'substantial modification'. However, we would encourage the ORR to continue to consider 'modifications' when assessing open access applications which should mean an operator is subject to the charge[5]. These include, as appropriate:

- **The financial consequences of a change or modification to services**. It is feasible that an existing open access operator could make a relatively small change to its service, such as journey time, which could have significant financial implications, causing significant abstraction from a franchise operator.
- **A change in the timing of a service**. This could potentially have significant abstraction implications for a franchise operator because time could affect passenger demand[6].

In these instances, while the actual change made could be relatively limited, the effect of the change could be substantial. DfT thinks such a change might warrant a service being subject to the ICC. Having extra consideration for these changes would enable the ORR sufficient flexibility to ensure that it was able to balance its statutory duties in particular circumstances where a change may have greater effects on taxpayers in practice than the service changes may suggest.

We should stress, however, that we would expect this flexibility to be relevant in only certain circumstances. We consider it would be reasonable that the burden should be on the party making the argument that there were greater effects than those reflected in the standard substantial modification definition, to provide an appropriate degree of certainty to open access operators making applications.

We also think and foresee that there would be an instance where a 'substantial modification' might mean that an open access service should not be subject to the charge. If an open access operator agreed to a change in their service in order to achieve a broader network or system benefit (e.g. in relation to timetable changes) that might, by definition or discretion, constitute a 'substantial modification', however that change would have an overall industry benefit and one that isn't inappropriately abstractive to existing operators, then we would consider it appropriate for the ICC to be waived in that instance to help support that beneficial change. We consider it appropriate that the ORR's policy preserves sufficient discretion to reflect this issue and the broader network benefits that might be secured.

[5] We recognise that in relation to certain changes these do not form part of the ORR's access decision. Our comments relate to the extent to which modifications form part of the access decision.

[6] For example, if the timing of a service changed from an 'off-peak' time to a 'peak' time. Or a service which is routed to be overtaken but a change in the timing means that it would not be.

Question 4.1: Do you have views about our intention to define the interurban market segment in terms of station demand and minimum distance? Do you have views on the proposed passenger and distance thresholds?

The DfT has very carefully considered the options with respect to the thresholds in the ICC consultation by reference to ensuring an appropriate balance between realising the benefits of innovative open access and the potential implications for taxpayers and the critical investment they provide in improving the network for passengers and freight users. In doing so, we think it is entirely appropriate that the ORR take an appropriately cautious approach for CP6, so that further changes can be on the basis of experience of their impacts in practice. We consider that this is particularly justified given that the ORR did take a cautious approach to the setting of the charge at £4 per mile, whereas the Systra analysis, which underlies the ORR's policy decisions in this area, indicated that in certain circumstances the market would be likely to bear a charge of £6-£7 (and in some instances a great deal more). Setting thresholds which secure a broader definition of interurban services would in our view be both appropriate in themselves, but would also focus on encouraging applications where markets may be less well served; this would provide a stronger incentive for genuinely innovative open access operators to open up new markets and serve new destinations.

Minimum distance

In terms of the proposed threshold for the minimum distance travelled to qualify for an ICC charge and the options ORR set out, DfT considers that even at 40 miles it would run the risk of limiting the application of the ICC unduly narrowly, which we consider will strike an inappropriate balance between facilitating open access and the interests of taxpayers.

We note that the ORR has concluded that long distance commuter services could bear an ICC. It is also worth noting that in the vast majority of outer suburban commuter services they primarily serve destinations less than 40 miles apart. This is particularly relevant in relation to services in and around the Outer Metropolitan Areas of London, where the long-distance commuter service is most likely to be relevant in practice. This would mean that, in practice, a number of services between London termini and key commuter centres were not covered by the ICC. This includes, for example:

- Paddington to Reading
- St Pancras to Luton and St Albans

While we recognise that the interurban definition relates to long distance commuter services, we consider that defining this at a level which means that some of the most significant and highly utilised commuter locations are excluded strikes an inappropriate balance. Ensuring a broader definition is also consistent with ensuring that new open access operators make an appropriate contribution to the longer term economic costs they impose on the network in some of the most congested areas of the network, as well as reflecting the ORR's PR18 objectives of ensuring a more efficient and better used network.[7] For example, the ORR acknowledge in the consultation document that, even at its lowest threshold suggestion of 40 miles, services between Manchester and Leeds or Liverpool would not be subject to the charge despite being clearly distinct urban areas.

[7] We note the ORR's draft impact assessment (at page 6) and the relevance of these factors in its assessment.

Station demand

We have very carefully considered the ORR's options regarding the thresholds for station demand, taking full account of the engagement between the ORR and DfT throughout PR18, and the clear need to ensure appropriate protections for the taxpayer. **In that light, and taking account of the ORR's statutory duties, we do not consider that any of the current options strike an appropriate balance between facilitating innovative open access and providing protection to taxpayers and their substantial funding for improvements to the network for passengers.**

As ORR will appreciate, if the station demand threshold is too narrowly defined, then here is a particular danger (even greater than that with the minimum distance threshold) that the ICC is purely academic and theoretical, impacting on very few new services and therefore not addressing the fundamental issue which it is intended to address. This is particularly clear when reviewing the station usage information which the ORR presents in its consultation document for all of the options. Using any of options 1, 2 or 3 as the relevant threshold would likely mean most new or significantly modified open access services would not be considered an interurban service and would therefore not be eligible for the ICC – notwithstanding that many of these are situated on routes that have been and continue to be recipients of considerable investment. This would mean that open access services on major intercity routes from a London terminus to each of the following urban stations, amongst many others, would not be directly covered:

- Sheffield
- York
- Newcastle
- Nottingham
- Milton Keynes
- Oxford
- Southampton Central[8]

Even applying option 4, this would mean that the following significant urban locations (and major intercity routes) would be excluded from the payment of an ICC should the service commence in a London terminus:

- Wolverhampton
- Peterborough
- Preston
- Chester
- Norwich
- Derby
- Bedford
- Doncaster
- Swindon
- Ipswich

[8] In this regard, we note the recent application by Grand Southern Railway for services from London Waterloo to Southampton Central, which the ORR rejected. We note that in our various discussions on this issue, we had not understood that there was a likely prospect that such a service might not have been subject to an ICC. Moreover, we continue to take the view that applying an ICC in the circumstances of that application would be entirely appropriate. Moreover, we note that London to Southampton was specifically identified by Systra as an example of an instance where the market would be likely to bear the costs associated with an ICC.

- Northampton
- Crewe
- Stoke-on-Trent

In all of these instances the stations involved have fewer than 5 million, but more than 3 million entries/exists.

This threshold would, in practice, render the ICC to be largely theoretical in many instances, which we would consider to fall within the definition of interurban and to constitute major intercity routes, striking, in our view, an inappropriate balance between the benefits of open access and the clear need to address the current imbalance in the charging position consistent with the PR18 Final Determination. In particular, as we describe above, ensuring an appropriate definition is consistent with ensuring that new open access operators make an appropriate contribution to the longer term economic costs they impose on the network, as well as reflecting the ORR's PR18 objectives of ensuring a more efficient and better used network. As ORR is aware, where this is not the case, such costs will predominantly fall to the taxpayer. **We would therefore advocate an Option which set station entries/exits at equal to or greater than 10 million users on the one hand, and equal to or greater than 3 million entries/exists on the other (i.e. Option 4 be amended such that S2 is greater or equal to 3 million).**

Adopting such a threshold, would, of course, not prevent a reconsideration of this issue, in the light of experience. To reiterate an earlier point, it may be that the ORR think it appropriate to trial any of the suggestions, such as the thresholds and how they would work in practice with open access applications. We are open to that approach and are happy to work with the ORR on this.

Additionally, we do have concerns that the 10 million threshold in Option 4, which we assume will be of most relevance to London termini could be subject, as the ORR recognises, to significant "gaming", with London stations which are not well suited to acting as termini becoming the focus of increasing open access applications. From an operational and capacity perspective, this could lead to significant concerns, particularly should this lead to delay or disruption to passengers or ineffective use of capacity on the network. We fully understand that the ORR will take into account these issues as part of its consideration of any individual open access application which used an alternative London terminus. **We consider that it would be useful to clearly reference that it recognises this issue and will consider the capacity implications as part of the ORR's assessment in the draft guidance.[9]**

Cumulative effects of thresholds

In addition to considering the individual thresholds, we consider it vital to consider the cumulative effect of the thresholds in practice, which we consider will substantially limit the impact of the ICC in practice, restricting the ability for the policy to fulfil its intended purpose and rendering the ICC, in practice, largely theoretical. For example, using the ORR's lowest thresholds as set out in the consultation would mean an open access service could be launched on these clear interurban routes without incurring an ICC:

- London St Pancras to Bedford[10]

[9] We note that capacity considerations are reflected in paragraph 1.9 of the accompanying draft guidance on the EET.

[10] Bedford has less than 5 million passenger demand, Luton and St Albans which are on the route and have greater than 5 million station demand is less than 40 miles to St Pancras

- London Kings Cross to Peterborough[11]
- London Waterloo to Portsmouth[12].
- London Paddington to Plymouth and to Bristol Parkway[13].
- London Liverpool Street to Norwich[14].

We have considerable questions as to whether, without trialling, this strikes an appropriate balance and properly safeguards taxpayers.

Question 4.2: Do you have suggestions for other characteristics that could be used as potential parameters for the interurban market segment?

We recognise the ORR's desire to ensure clarity for parties making open access applications by limiting the extent to which discretion is exercised. However, due to the nature of the rail network in Great Britain, we consider that this is not appropriate. There are many particular local circumstances, which mean that fixed thresholds risk being inappropriate in practice. This is particularly the case where, for reasons of history, a discrete urban location may benefit from several stations, where if it were served by a single station it would meet an appropriate station demand threshold (whether that be 3 million or 5 million entries/exits for S2). Not recognising these realities of the operational railway would run a significant risk of an arbitrary bright line test, which ultimately does not properly reflect the implications for taxpayers of additional open access applications serving a particular locality.

These include (depending on the threshold employed), for example:

- Portsmouth
- Warrington
- Exeter
- Bradford
- Windsor
- Canterbury
- Wakefield

There are also likely to be other instances where such discretion is more appropriate to reflect the operational realities of the railway.

We **therefore advocate that the ORR should reflect in the guidance the scope for appropriate discretion to be applied in particular circumstances.** Recognising the need for certainty, however, we would advocate that the burden should be on the party advocating that the ORR should exercise discretion to provide evidence that the relevant station usage threshold is not appropriate in the particular circumstances.

DfT also requests the ORR to broaden the definition of the interurban market to include the infrastructure used to create a clear presumption for circumstances in which the ICC will be levied.

[11] There are stops at Huntingdon and Stevenage which have less than 5 million station demand
[12] There are stops at Petersfield, Haslemere, Guildford and Woking which have less than 5 million station demand
[13] Reading is less than 40 miles from London, and all other stations have less than 5 million station demand
[14] Colchester, Ipswich, Norwich – all stations have less than 5 million station demand

DfT believe that there should be a specific presumption that if an open access operator is running services on the West Coast, East Coast or Great Western infrastructure, the operator should be subject to the ICC. This is consistent with the CMA's findings that these are the three main intercity lines where open access is most likely to be relevant.

Given the specific importance of these mainlines to passengers, communities and the economy, and the significant investment that funders have made to ensure that maximum benefits are obtained from them,[15] we consider that it would be appropriate for a provider seeking to use these services to be willing to pay an appropriate economic cost for those paths, encouraging their efficient use. This would also have the benefit of ensuring that prospective open access operators were clear that running services on these mainlines would attract an ICC, enabling them to plan their business with an appropriate degree of certainty.

Question 4.3: Do you have views about the proposal to include all stations within a certain radius of busy stations within the interurban market definition? Do you agree with the proposed two-mile radius?

In the absence of a strong empirical approach, **DfT agrees with the ORR's radius of 2 miles, albeit we consider that it would be appropriate for the ORR to retain the scope for using its discretion in particular circumstances**. In particular, while this radius is likely to be appropriate in London, it may conceivably be inappropriate in practice elsewhere in the country, with specific local geographies. This could lead to inappropriate "gaming" of the system to avoid the ICC, notwithstanding the potential for the new service to lead to detrimental effects in practice. Recognising the need for certainty, however, we would advocate, as we do in relation to the substantial modification threshold, a specific reference to the scope for discretion being inserted in the guidance; alongside this we would suggest that a clear indication is provided that the burden will be on the party concerned to provide evidence that the two-mile radius is not appropriate in the particular circumstances of any individual open access application.

Question 4.4: Do you have views on whether ORR's discretion should sometimes be used when determining whether a new open access service is part of the interurban market segment? How could we exercise that discretion? Do you have views on what may be relevant guidelines for the discretion?

It is important that the ORR considers the impact on the taxpayer when considering whether to charge the ICC and recalls the importance for the efficient use of the network that operators make appropriate contributions to the costs that they impose. This is what DfT encourages to be the foundation for the ORR to determine how to exercise any discretion, ensuring that, consistent with the ORR's policy intent, all genuine inter-urban services are included within the scope for the ICC. **We would therefore strongly advocate an appropriately inclusive approach to considering services in an application would be part of the interurban segment where discretion is relevant**, reflecting that were they are not included, the taxpayer ultimately will bear some of the costs of these services – funds which could otherwise have been uses to improve outcomes for passengers.

[15] These include the East Coast Connectivity Fund, the investments in the Intercity Express Programme, the West Coast route modernisation and the Great Western Electrification Programme.

Response to the EET consultation

The Government strongly supports the introduction of this test and believes that it will provide an additional necessary foundation for considering open access applications, helping to ensure that the passenger benefits provided by the competition for public service contracts are maintained. We welcome the ORR's proposed guidance in this regard, most particularly the approach set out in Chapter 4 of the proposed guidance with the clear recognition of the need to address taxpayer implications; [16] we also fully recognise that the DfT will have to work with the ORR in providing the relevant information to conduct the EET – we will be happy to do so. More generally, we consider that the draft guidance draws an appropriate balance between the benefits of open access and the implications for taxpayers and the investment they provide to improve passenger outcomes. Indeed, in material respects, we considered that the wording and tone in this document was closer to our view on the appropriate balance than in aspects of the consultation document on ICC.

With respect to points of detail:

- We strongly support the ORR's clear position (from 5.22 of the draft guidance) on **preserving the confidentiality of the information** provided to parties (including the DfT) in relation to the EET. We recognise the ORR's obligations under section 71 of the Railways Act 1993 and the need to assess any potential disclosure in the circumstances of a particular case, but given the high levels of commercial sensitivity and the need to ensure that the ORR has sufficient information to conduct the EET, we consider that a robust approach to commercial confidentiality is entirely appropriate.
- We note the provisions regarding the process during a competitive tender of a franchise. The UK Government strongly advocated for these provisions in the negotiation of the relevant implementing regulation, recognising the potential negative implications for passengers and taxpayers of the uncertainty occasionally by an open access application during a tender process. We understand the ORR's position on considering this, but consider that it is likely, in any particular circumstance, that it would be appropriate to suspend consideration during the tender, to the extent permitted. Equally, we understand the ORR's position with respect to temporary access, which we also consider will generally be inappropriate in most instances, is that such access could only be granted following an NPA test being applied – we consider that it would be helpful for this to be set out explicitly at 5.28 of the draft guidance.
- We consider that it will be important, in the light of experience, for the ORR to keep under review how the EET and NPA tests relate to one another, given the "overlaps" the ORR mentions, to ensure proportionality – we very much encourage it to do so
- We advocate that, as we describe above, the approach to substantial modification is adapted to enable sufficient flexibility to reflect the effects of modified open access operations in particular circumstances.
- In respect of 4.12, we note the reference to "authority's total budgets" being relevant to the assessment of net cost for funders; we consider it appropriate that this relates to railway franchising budgets from a UK Government position, rather than the overall UK Government transport budget as a whole. It may also be relevant to take into account the overall fiscal circumstances when conducting this analysis, where we would be happy to provide appropriate information to the ORR as required.

[16] We particularly welcome, for example, the reference to the potential usage of Webtag in assessing wider benefits. We consider that to be entirely appropriate.

- We agree that a fee should not be applied for the provision of an EET at this time.

Open access monitoring policy

We note the ORR's proposed guidance on monitoring the impact of and response to open access operators and welcome the comments about working with the DfT on the role of open access during the Williams Rail Review.

Consistent with our remarks above regarding the balance of the ORR's statutory duties, **we consider that a clear and specific reference in Chapter 1 to the impacts on taxpayers, clearly reflected in the EET consultation and the ORR's overall policy position during PR18, would be useful in establishing the appropriate context for this policy**.[17] Similarly the considerable passenger benefits obtained through the competitive franchising system, which open access could complement, should in our view be reflected in Chapter 2 of the document, providing appropriate context for the additional potential benefits offered by open access operators.[18] The benefits of franchising as a system include those that directly come from bidders through competitive award but also include those that come from public sector specification and the wider ability of the franchising authority to plan and develop the railway in the round.

With respect to the substance of the ORR's document, we fully recognise and support the importance of ensuring that inappropriate, anti-competition behaviour which prevents the realisation of the benefits of competition to passengers is fully addressed. However, we have considerable questions about the objectives set out in the ORR's proposed document. In particular, we note the reference to the ORR "*seeking to ensure that any barriers to the growth of open access*" are to be addressed. In our view, the appropriate standard, should instead be that unlawful or illegitimate barriers to effective competition generally (including to open access) should be addressed. Clearly legitimate competition from franchised operators, which will benefit passengers, may well impact of the growth and development of open access operators. In the interest of ensuring passengers obtain the full benefits of competition, we consider that the policy document would benefit from being very clear that the focus is unlawful restrictions, so as not to chill lawful, legitimate competitive responses from franchised operators.[19] Certainly, we consider that it would be most unfortunate if the effect of the policy was to restrict such a competitive response for fear of attracting enforcement action under the Competition Act 1998. Moreover, we note the reference, in ensuring fair treatment, the explicit reference, under Chapter I of the Competition Act 1998, to anti-competitive agreements; we consider that it would be helpful in this section to avoid any misunderstanding that many agreements can have pro-competitive effects. In particular, both the Government and the ORR through PR18 have been strongly encouraging closer working between Network Rail and train operating companies to ensure better outcomes for customers. A clear reference to the potential pro-competitive benefits of appropriate co-

[17] This could be included at paragraphs 1.4 and/or 1.8 of the draft document. Similarly, we note the reference in 1.6 to the First Group application to run services to Edinburgh from May 2021. We note that the considerable implications for taxpayers from that services are not reflected in this paragraph.
[18] We note that such a nuanced approach has been a well-established feature of multiple ORR documents on this issue. We note, for example, paragraph 1 of https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/505835/Office_of_Rail_and_Road.pdf
[19] We note in particular the very well-established case law under Chapter II of the Competition Act 1998/Article 102 of the Treaty on the Functioning of the European Union that abuse of a dominant market position is occasioned where an undertaking has recourse to methods different from those which condition "normal competition". Being clear that normal competition remains entirely appropriate and consistent with competition law would, in our view, be helpful.

operation, particularly including vertical agreements, would avoid any confusion of the type that could chill arrangements which are in the interests of passengers.

In the context of the Williams Rail Review, it would be helpful to ensure that any engagement explores the issue of how benefits to different groups of passengers, communities, the economy and the wider nation are – in principle – expected to be delivered in any restructuring of the railway system. The Review seems to provide a useful opportunity to ensure a clearer, shared understanding of the role and objectives for on-track competition in the future system.

With respect to the deliverables for further action, we agree that further work in this area would have merit, particularly to ensure clarity for incumbents as to the type of behaviours that might attract competition law scrutiny, so as to avoid chilling appropriate pro-competitive responses. As part of the stakeholder engagement referred to in the document, we would welcome the opportunity to work with the ORR on this issue and would encourage it to work closely with franchised operators to ensure that any guidance produced provides clear indications as to what would could be likely constitute unlawful behaviour, supported effective pro-competitive responses.

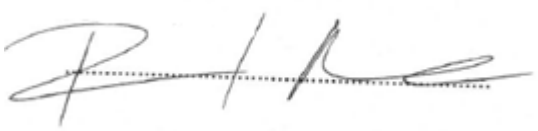
More generally, we consider that, consistent with the ORR's helpful response to the DfT's consultation on the PSO levy[20] and the role it considered it could play in the implementation of the PSO levy, we consider that a further aspect of the ORR's work in relation to open access would be to continue to assist the DfT with the design of the levy in preparation for its introduction when parliamentary time allows; we consider that it would be helpful if this was reflected in the ORR's deliverables.

Concluding remarks

We welcome the close working relationship we have had so far on PR18 and the clear recognition of the need to ensure appropriate charges for open access operators. However we do currently have concerns that aspects of the consultations should more fully reflect the full implications of open access to taxpayers and the vital investment that they provide to improve the railways for passengers and freight users; we have offered practical, constructive suggestions on these areas, which we hope are of assistance.

We would be very happy to discuss any of the above. More generally, we look forward to continuing to work closely with the ORR on this issue in the coming months and years, helping to ensure that the railway fairly delivers for passengers, freight users and taxpayers.

Yours sincerely



Dan Moore

[20] http://orr.gov.uk/__data/assets/pdf_file/0019/25372/orr-response-to-dft-public-service-obligation-levy-consultation-2017-05-09.pdf

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Natasha Frawley

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14th January 2019

Dear Natasha,

Response to ORR's Consultations: (a) Open Access Infrastructure Cost Charge Implementation (b) Guidance on the Economic Equilibrium Test

Thank you for the opportunity to respond to these consultations in relation to Open Access Operators (OAO) following on from ORR's conclusions in the Final Determination published in October 2018. This response is made by FirstGroup on behalf of our Rail Division and its train operating companies: Great Western Railway; TransPennine Express; Hull Trains; East Coast Trains Ltd; and South Western Railway (which is a joint venture between FirstGroup and MTR).

As you will already be aware FirstGroup has, through the PR18 process, held a number of discussions and submitted specific responses to the ORR in relation to the treatment of, and policies for, OAOs for CP6. With this in mind, we welcome confirmation of the arrangements for OAOs for CP6 that were outlined in the Final Determination, as this helped to provide some clarity on how the policies and charges will apply for new and existing OAOs in CP6. This is of particular relevance for FirstGroup as we have both an existing OAO in Hull Trains, and currently mobilising for the commencement of services for our East Coast Trains business, which will fall under the definition of a new OAO for CP6. However, there remain some aspects where further consideration is required to provide greater certainty and increased clarity. This is the focus of our response.

Taking each of the consultations in turn:

(a) Open Access Infrastructure Cost Charge Implementation

Changes to the NPA Test

We agree with the ORR's decision not to change the NPA test threshold. The current value represents a sufficiently challenging level for an aspirant operator to achieve and is one that demonstrates that there is clear incremental revenue generation from a new market. We do agree that the contribution of the ICC should be recognised in an application and that the most logical way to do this is to take account of the amount paid as part of the NPA test.

This ensures that the OAO in question is able to access a greater share of the market, which is wholly appropriate in this revised approach.

We welcome the ORR's consideration of an alternative approach to considering the contribution of the ICC and would agree that Option 2 (subtracting the ICC from revenue abstracted) has a clearer rationale than Option 1 (adding ICC to revenue generated). As set out in the document the ICC paid by the OAO is helping to fund the cost of the railway and it is therefore logical to subtract it from revenue abstracted.

We are keen that the ORR applies the final arrangements specifically to East Coast Trains Ltd (ECTL). This OAO had its track access rights granted on the basis of the arrangements in CP5, but with a note that it would be subject to changes in charging arrangements for CP6, as it would be classed as a "new" operator. Subject to ECTL also being confirmed as providing an inter-urban service, then it will have to pay the ICC. If this is to be the case then it must follow that ECTL should be allowed greater access to the market and therefore for the revised NPA test to be applied in the event that ECTL proposes an alternative calling pattern. As it stands and with no change to calling patterns with the revised test applied, ECTL would, all other things being equal generate a higher threshold than 0.3. This would be consistent with the position outlined to FirstGroup in the ORR's letter of September 2018 in response to questions raised by the Draft Determination in respect of OAO policy.

Definition of Substantial Modification

We are concerned that the definitions proposed (additional station calls; changes in frequency; and changes in the number of stops) are too low a threshold. With these arrangements in place any small modification to an existing service would be captured by the policy and that operator would then have to bear the cost of the ICC. This cannot be the intention of this element of the revised policy.

To give a practical example, it may be that an existing OAO such as Hull Trains is seeking to merely move calls between existing services and has even been required to do so as a result of the timetabling process. To therefore levy the ICC in this case would not be consistent as there is not a material change in the overall level of service currently being offered.

As proposed the definition would also mean that where an OAO is seeking to run an additional service that requires some changes to its other services, perhaps to give a more appropriate spread of calls, then not only would the new service be subject to the ICC but the existing amended services would be as well. This despite the fact that the majority of passengers would be unaffected. This again does not seem logical or appropriate.

Having considered this carefully, we would propose the following modifications to the definition of a substantial change being:

- Where more than one additional service in each direction per day is proposed;
- Any additional service arrives or departs in the relevant peak period at a London terminal station;
- The overall number of calls at each station for that operator does no increase by more than one per day in each direction; and
- Any additional calls are at a station for which the operator does not already have rights to call.

Proposed Definition of Interurban Open Access Market

Whilst we recognise that the ORR is using the term "inter-urban" as a proxy for those services that are most likely to be able to bear ICC. However, we have some concerns with the approach that has been taken and that there needs to be further analysis and consideration of wider factors.

In the consultation document the ORR sets out that its advisors had concluded that there are three determining factors in respect of the ability to bear charges: market geography; time of day; and journey purpose. Whilst the ORR has decided to focus on geography only, there are ways that these other factors could be considered. For example, the ORR has dismissed time of day claiming that industry data sources do not provide information at this level of detail – this is not the case.

It is also worth noting that in concluding that major intercity and long-distance commuter services are likely to be able to bear the ICC the ORR's advisors assumed that OAOs have no restriction on their access rights. However, this does not reflect the current reality that all OAOs do face some level of restriction to the market.

Turing to the approach that has been taken and the methodology that has been proposed, whilst we appreciate the work that has been undertaken, we feel that further development is required. As such, we would make the following observations and proposals:

- The use of gateline data to distinguish the threshold for whether a station meets interurban status in the context of Open Access is not helpful. There will be heavy bias towards commuter lead stations which offer minimal network capacity in the peak. An alternative would be the use of LENNON sales data between station pairs – at least this would enable a transparent way of excluding peak commuting volume that would sit outside the Open Access target market. This would also enable the filter process to be taken at the station pair level which would be more relevant than individual station. LENNON sales data is available to much of the industry.
- Using data from a single year is not appropriate for single stations as Hull Trains has proved. There are often factors within a year that can materially alter revenue. These include special events, major engineering works and significant unplanned disruption. A normalisation approach should be adopted by considering data over at least a rolling two to three year period.
- In terms of distance, the approach to using a straight line distance between stations and then including stations within a 2 mile range works for urban areas that contain stations in close proximity but it is less clear on how this works for parkway stations that provide an alternative to city centre, and are on average more than 2 miles apart. The expectation is that journey times will decrease over time as such perceived distances reduce.
- A large number of the stations in the 5m to 10m footfall category are dominated by short-distance flows, which would mean they are not necessarily "inter-urban"
- A threshold of 40 to 60 miles does not account for current commuting trends, which suggests that these are not long-distance flows
- No account is taken of competing markets, such as air, which on long distance flows will act as a constraint on pricing, thus affecting profitability when an OAO also has to bear an ICC.

Finally, we are concerned that the ORR is still intending to apply a level of discretion when considering applications. Whilst we accept that this is intended to be only for those cases that are marginal in respect of passing the various tests put in place, this does nothing to

improve clarity or certainty from aspirant operators or their competitors and more importantly funders. We would therefore advocate that the ORR considers further factors that could be used to reduce uncertainty in the process and remove or at the very least significantly reduce the need for discretion. One such factor could be speed of service, compared to other services on the route. It is often the case that new OAO services, even if they wish to compete on speed, are subject to slower journey times and are therefore not able to compete on all aspects of service.

(b) Economic Equilibrium Test

It is of vital importance that prospective OAOs have certainty and clarity as to how their applications will be considered by the ORR. We therefore welcome the publication of the draft guidance on the Economic Equilibrium Test (EET).

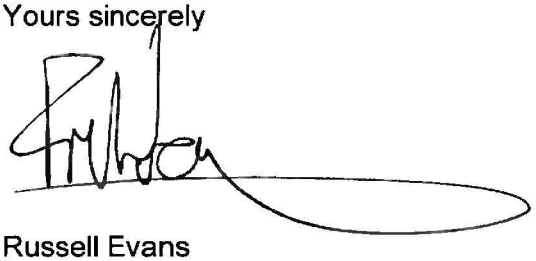
It is helpful that the ORR has clarified a number of aspects of the test, such as confirming that the EET will reflect the basis on which the relevant Public Service Contract (PSC) was granted as well as taking into account forecast and actual financial performance of that contract. However, the EET will need to account for changes that are made to the PSC by the relevant authority. Furthermore, there will need to be a requirement for the authority to confirm which elements of the PSC are commercial in order that the test can be fairly applied.

The EET will, as set out by the ORR, need to be considered alongside the NPA test. It also follows that the change in access policy associated with the NPA test (i.e. in relation to the ICC) also means that there should be consistency of definitions of aspects such as "substantial change to services". Any test should also take account of contributions to the Network made by the prospective OAO including ICC where this is incurred.

There are, however, aspects of the draft guidance that need further development. In particular this concerns providing clarity on the thresholds or benchmarks that have to be achieved in order to pass the test. In addition the guidance on "wider benefits" needs to be adequately defined as it is not clear how this will be assessed and applied on the test. Finally, whilst, following the test it is recognised that the ORR may require changes to the application it is not clear how any changes that are required to the PSC will be applied or enforced.

Once again, thank you for the opportunity to respond to these consultations. Should the ORR wish to discuss any aspect of this response in more detail please do not hesitate to contact me. We will provide a copy of this response to RDG and Network Rail.

Yours sincerely



Russell Evans

Policy & Planning Director, First Rail

PR18 consultation on open access ICC implementation

This pro-forma is available to those that wish to use it to respond to our consultation. Other forms of response (e.g. letter format) are equally welcome.

Please send your response to natasha.frawley@orr.gsi.gov.uk by **14 January 2019**.

Full name	Ian Yeowart
Job title	Chief Executive
Organisation	Grand Union Trains
Email*	
Telephone number*	

*This information will not be published on our website.

Question 2.1: Do you have views on our proposal to add ICC income to revenue generated in the NPA test when assessing new (or substantially modified) interurban open access services?

Grand Union's responses will address the questions specifically, but this is not an endorsement of the principle of the introduction of discriminatory charges on new aspirant operators. Grand Union refer the ORR to its full response on this issue in August 2018 during the previous PR18 consultation, which is relevant to this consultation.

While the proposal to add ICC income to the 'interurban' element of new open assess (OA) services will make the attainment of the NPA threshold easier, it may make the ability to deliver a financially viable competitive service more difficult as it will result in a higher operating cost. For the benefits of competition to accrue to passengers, both (or all) operators on the route need to be able to operate profitably. Domestic aviation illustrates this very clearly. This additional charge may restrict the number of routes on which on-rail competition can operate, which will be to the detriment of the whole industry and its passengers. Therefore, far from achieving the ORR's stated aim of encouraging more open access services, its new policy is likely to do exactly the opposite.

The position that ORR is adopting makes it perfectly logical to include income from the ICC as generated revenue to be included in the NPA test., so, subject to our initial comments in the first paragraph, Grand Union would support this change.

However, the NPA also now needs to take into account the significant financial payments and benefits that routinely accrue to franchise operators and Network Rail from the introduction of new OA services. Unlike the ICC which is proposed to be set at an arbitrary level, with no linkage to cost causation, there is considerable income for franchised operators where competition is allowed which can be specifically quantified, and logic requires that this income also needs to be taken into account.

For example station access charges, electrification infrastructure charges, ticket retail commission, and charges for maintenance provide significant revenues (and profit) for operators and Network Rail, and should be 'off-set' against any 'abstracted' income . There are also contributions made to many industry overheads such as BTP, RSSP, RSP, ATOC schemes etc.

ORR has not presented any justification for not taking into account all these payments which operate as a contra cash flow to any alleged abstracted income and we consider that natural justice and the integrity of ORR as an impartial regulator requires consistency in the application of ORR's access policy.

Of the options outlined, Grand Union would accept the proposal to add ICC income to revenue generated in the NPA test, but additional revenue 'earned' by the franchise from the introduction of new OA services should also be added.

Question 3.1: Do you agree that the substantial modification definition is appropriate for determining if a modified service run proposed by an existing operator is in scope to pay an ICC?

It is unclear why ORR proposes to give current OA operators a significant commercial advantage by not levying an ICC charge on any 'interurban' sections of their services (should they be deemed as such). The ORR has not given any reason behind its thinking on this matter. This appears to make any proposed charge against a new open access operator (OAO) discriminatory.

The situation on service expansion is also much more volatile than the ORR seems to believe, and an increase in service frequency by an OAO cannot just be viewed as a 'substantial modification' without being fully aware of the changing circumstances that prevail on nearly every occasion that an OAO introduces services that benefit passengers.

On the ECML, when Grand Central first introduced services, the franchise operated 33 daily services between London and York. The franchise now operates over 30% more services and runs more 'additional' services than Grand Central operates in total, with even more proposed.

In the expectation that this pattern of behaviour from a franchise in response to competition would occur elsewhere when competitive services are introduced, it would be discriminatory for the smaller operator to be further penalised for seeking to protect its position by expanding its service, particularly where its initial service proposition will be diluted by further franchised services. Furthermore, the places served by OA operators may be discriminated against as the impact of having to pay the ICC may well be in excess of the income that would be gained as a result of any 'substantial modification'. By their very nature OA services are relatively recent in their operation and many are developing their markets, so up until now, they have started small and grow as the market grows. The effect of the approach proposed by ORR runs a serious risk of freezing the development of existing OA services, which discriminates not only against the OAO, but also against those communities that are served by OA train services, in comparison to those served by franchise train services.

The test should not be on additional services, but on additional services in relation to the increase in franchised services. A change in the number of services or a changing stopping pattern does not fit the standard definition of substantial change in such circumstances.

The ORR is also aware that franchises, with the agreement of the DfT, often seeks to introduce further services and vary the stopping patterns to 'fill' available track capacity. and prevent competition. A number of these are clearly not 'commercial' – we would cite the proposed services to Lincoln (NXEC) and Middlesbrough (Virgin/LNER), and so should be dealt with by the ORR in relation to the EE test – where such services would reduce premiums or increase

subsidy requirements – in effect PSO services designed to drive away commercial services. An area that I am sure will be addressed by the ORR in future monitoring.

Question 4.1: Do you have views about our intention to define the interurban market segment in terms of station demand and minimum distances? Do you have views on the proposed passenger and distance thresholds?

This proposal appears to be a reintroduction of the original Moderation of Competition (MOC) provisions which were designed to protect franchises in the early years of privatisation. They were replaced by the introduction of the 'five stage process' which also includes the NPA test. As noted elsewhere in Grand Union's response, far from reforming the access arrangements for OA for the benefit of passengers, this overall proposal adds another level of complexity and difficulty to an already complex and time consuming process, whereby OAOs are seeking to secure access rights and develop new markets.

However, as part of an arbitrary regulatory process the methodology is simple and comprehendible, which has a lot to commend it.

If ORR considers that this regime is legal, then the 10m passenger threshold and 50 miles as the range should be adopted as outlined by the ORR.

Question 4.2: Do you have suggestions for other characteristics that could be used as potential parameters for the interurban market segment?

To even reach the stage where these considerations are met, proposed OA services must have passed the NPA test. At least the proposals as outlined are clear (if unfair and discriminatory) and would, like the MOC provisions, give applicants visibility of the likelihood of their proposal falling into the 'interurban' segment.

Question 4.3: Do you have views about the proposal to include all stations within a certain radius of busy stations within the interurban market definition? Do you agree with the proposed two mile radius?

This criteria should only be applied for services that follow (generally) the same physical route as franchised services with similar journey times. Grand Union is aware the ORR has indicated there may be perverse incentives by running slower trains, but that would not apply for services arriving at a similar location via a different (longer) final route.

GNWR proposed services from Euston to Leeds via Manchester Victoria and Huddersfield in 2010, with services arriving/returning to the WCML via Newton-le-Willows. Under this definition

such services would be ‘swept up’ in a 2 mile radius catch all scenario at Manchester and required to pay the ICC which would immediately render them unviable, so they would not be operated. As a consequence, the very considerable connectivity benefits which these services would have offered would be lost.

Furthermore, in many cases the stations that are included within the 2 miles (or even a 1 mile) radius are on different routes, so potentially offer different connectivity options. This somewhat arbitrary approach would have the effect of further reducing the opportunities that OA offers to develop new travel opportunities that the existing network is not providing for, again contrary to the ORR’s stated aim of encouraging more OA services.

Question 4.4: Do you have views on whether ORR’s discretion should sometimes be used when determining whether a new open access service is part of the interurban market segment? How could we exercise that discretion? Do you have views on what may be relevant guidelines for the discretion?

We consider that ORR should be able to make use of its discretion in determining whether a new OA service is part of the interurban market, but only if requested by the OA applicant who will balance the risks of seeking discretion against any potential extra work or delay. We would like further discussions with the ORR as to what areas of discretion they may be considering. We expect the applicant to be able to withdraw their application for discretion at any time.

A further consideration for determination should be the number of new direct journey opportunities that arise. For example, when Grand Central started its NE service, new direct journeys were created between London and each of Thirsk, Eaglescliffe, Hartlepool and Sunderland, as well as between York and each of Eaglescliffe, Hartlepool and Sunderland. Grand Union contends that where over 50% of new ‘direct journeys’ are created (from the total point to point journeys within the service), then that criteria should also be used in determining whether a service is ‘interurban’.

In the above example, if applied for now, the fast leg between York and London could be determined* as ‘interurban’, and this would have made the operation uneconomic (from an initial modelling perspective), and yet the very significant passenger and economic benefits that have accrued within the NE are very important. The risk to such further services must be taken into account.

On a further point, if, for example, Grand Central then proposed* to call services at Newcastle (on their way to and from the train maintenance depot), under these proposals the entire length of the service could be regarded as ‘interurban’ despite the very significant different journey times.

*If the ORR used 5-10m entries/exits as the base

See also Grand Union’s response to 4.3.

Any other points that you would like to make

The ORR has still not addressed the point regarding the legality of levying a fixed charge on open access operators. In the interests of transparency and in accordance with good practice regulation, ORR should publish its legal advice on this issue.

In 2006, the ORR won a significant victory in the High Court - The Court had regard to the purpose of Directive 2001/14/EC. It said:

“The focus of the Directive is clearly on the need to ensure that all railway undertakings have “equal and non-discriminatory access” to [the “upstream” market for] rail infrastructure. If the ORR’s charging scheme does not reflect differences between the ability of undertakings that perform services of an equivalent nature in a similar part of the “downstream” market to obtain access to the “upstream” market it will not achieve the objectives of the Directive.”

Referring to the Directive’s statement that charging and capacity allocation schemes should allow for fair competition in the provision of railway services, the Court added:

“Fair competition in the provision of railway services will not be possible if those operators who wish to provide such services are in an unequal position when seeking access to the necessary infrastructure and the charging regime makes no attempt to address that inequality.”

The Court decided that the market conditions under which franchised and open access operators are able to obtain access to the infrastructure are, in practice, “very different indeed”. It described them as “chalk and cheese”.

They therefore occupy different segments of the market. This has still not been addressed in ORR’s analysis and therefore has not resulted in ORR making any substantive proposed change to access policy to address the inequality.

The judgment analyses the very different circumstances of franchised and OAOs and rules on how those differences not only justify, but require, a different charging framework. The legal basis on which the ORR now seeks to challenge the judgement, which was very much in its favour, has still not been explained in any of the consultation documents.

The ORR is still focusing charging based on the ‘downstream market’, when it was clarified in Court that charging is focused on the ‘upstream market’, the market for access.

Any charging regime must be measured against the overall objective of Directive 2001/14/EC, and that is not to allow incumbents with significant advantages to exclude competitors who are willing and able to use the network and provide competitive services for passengers.

If, however, we ignore for a moment the introduction of the ICC charge (on more ‘traditional’ and non ‘interurban’ services), the ORR has still failed to show what improvements – if any – are proposed to ease access into the ‘upstream market’ for new open access entrants.

The thrust of the proposal appears to be an attempt to minimise possible impact on incumbent franchise operators, usually long term franchise holders, where the thrust of the EC directives is to increase competition and seek improvements and choice for passengers. In other regulated industries the economic regulators main thrust is seeking to encourage competition rather than trying to seek ways to limit or prevent it.

It is considered that the whole assessment of competitive services needs to move into a new era, reflecting the maturity of the privatised industry and the opportunities that are arising. For the first time, there is an excess of good quality rolling stock becoming available which can be used to develop a whole range of new services for passengers. The alternative is that if OA services are supressed or the obstacles are too high, then much of this rolling stock will go for scrap prematurely, which is neither financially or environmentally sustainable.

The whole of the current ORR driven analysis is based on traditional railway appraisal – itself based on PDFH, which is substantially based on the former BR experience. At that time, and in practise to date, the train service has been fairly homogeneous - in that there is little distinction between the service offer on a particular route and where there are parallel operations, with different companies, the differences are usually clear - such as London - Birmingham where the secondary operators are slower and have lower frequency, both of which are well documented in the PDFH.

On a potentially fully competitive route such as London – Edinburgh, where ORR has agreed to a competitive service being introduced - the OA is planning to offer a different experience/offer to the potential passenger. In this case the whole OA proposition is based on price, and a pared back customer experience.

However on other routes new OAs may offer the opposite - a high quality intercity experience compared to what is there currently. Whilst the price based competition is fairly easy to model, the characteristics of quality are much less easy to model and to put into mathematical form, are much more variable and are also less certain in their outcome as it will depend on the trade-offs that users will make between a range of factors such as comfort/passenger experience vs frequency. But the opportunity to provide that new and different passenger experience, arising from a private sector risk taking venture, is at the behest of a, currently, very cautious public sector based regulator, part of whose main driver appears to be to protect the DfT monopoly.

OA has been around on the ECML for almost 20 years, with an established and stable pattern for nearly 10 years. There is significant evidence available on the benefits that OA has brought to the route, its passengers, communities and competitors, and there needs to be much more of an evidence based approach to decisions rather than the perpetual modelling by consultants of services for which many of the attributes cannot be valued by a model alone - and there are few consultants with experience in open access operations and their development.

We consider that, where the OA proposal offers a different type of train service, with a differentiated product (based on customer experience, i.e. not just a low price) the ORR needs to refine its approach. It should let the market assess whether the alternative offer is one that users want. If the OA is successful in attracting passengers from the DfT/franchise services surely that tells them that the DfT/franchise specification is not meeting the market need. The ORR would expect a competitive response in such instances from the franchisee (and possibly from DfT), the very reason why competition is to be encouraged. That is the essence of competition and also economic efficiency!

We also consider that the ORR needs to fully consider the further benefits that OA operators bring – quality jobs, funds to the Treasury from income tax, NHI, company tax, fuel tax (for diesels) and the wider social and economic contributions that these additional services provide – and not just when evaluating competing bids for capacity. The wider economic value to the North East, West Yorkshire and East Yorkshire arising from the OA services far outweigh the highly inflated impact figures quoted by the DfT and the various monopolistic suppliers. We are not aware that the ORR has been provided with any evidence that there is actually any material impact on a franchise (where an OA operates) or on the funds available to the Secretary of State.

But OAs can, and do, offer a lot more - an opportunity to innovate and experiment as they are not tied to any DfT contract and specification. Innovation is at the heart of the developing railway and is receiving very considerable funding in the context of technical innovation, but innovation in customer service and experience is equally, and possibly, more important, so it needs to be given the opportunity to develop, and that is rarely done on a spreadsheet. It is no

coincidence that the OA operators are so well liked by their passengers and consistently top satisfaction surveys.

For the EE test the ORR needs to ensure that it very much works both ways so the impact on existing and future OAs is properly assessed - the example being the VTEC (now LNER) Middlesbrough service impact on Grand Central. This proposed service needs a considerable investment in the infrastructure to get it to happen (which was not factored into the analysis), and it should fail the EET not only because of the potentially catastrophic impact that it could have on Grand Central - which at worst if it folded would deprive Hartlepool and Sunderland of their established long distance services – but also because the service (as shown in the analysis) is a loss making PSC.

Thank you for taking the time to respond.

Heritage Railway Association response to consultation on ORR's draft guidance on the Economic Equilibrium Test

I am responding on behalf of the Heritage Railway Association to the ORR consultation on the Economic Equilibrium Test.

We represent 315 organisations in the UK and Ireland who run and support heritage railways, museums and tramways.

Many thanks for including the Heritage Railway Association (HRA) in your consultation regarding the Economic Equilibrium Test.

The HRA does not have any specific comments on the proposed methodology in the consultation documents. However we would be interested to see the results of test if one of our members wished to use their connection to Network Rail on a seasonal basis to run trains over Network Rail infrastructure to widen the potential traffic flows.

I am content that this response is published without redaction excluding my email address and phone number.

Regards,

Ian Leigh

LONDON NORTH EASTERN RAILWAY

East Coast House, 25 Skeldergate, York YO1 6DH \ LNER.co.uk

Access and Licensing Team
Office of Rail and Road
One Kemble Street
London WC2B 4AN

14 January 2019

Dear Sir / Madam,

Economic Equilibrium Test ("EE Test")

Thank you for the opportunity to respond to your recent EE Test. I am writing on behalf of London North Eastern Railway Limited (LNER).

LNER is supportive of the new EE Test and notes the circumstances where it is entirely appropriate to carry out the test such as where there is evidence that there would be a substantial impact on the economic equilibrium of a public service contract resulting from a new open access service or where there is a "substantial modification" of an existing open access service.

LNER is concerned about the narrow definition of "substantial modification" – it should not just include an increase in service frequency or additional station stops. The definition should also include any change to the number of station stops and any any change to journey times.

We would welcome further definition of the "substantial negative effect" concept with clear thresholds and pre-set decrements to profitability that would constitute a "substantial impact". The planned approach gives ORR a very wide discretion and whilst in theory any decision can be challenged, in practice this will be difficult to do so successfully.

The information requirements detailed in 5.18 and 5.20 could be onerous for the PSC Operator, particularly when the PSC Operator has not requested that an EE Test is carried out.

The information required of the applicant (as detailed in paragraph 5.21) is reasonable. However, it would be possible for an applicant to implement pricing strategies and ticketing arrangements and marketing strategies entirely different from those shared with ORR at this stage. ORR should not treat this information as the only possible scenario when carrying out an EE test.

In terms of requesting a reconsideration of a decision, please can you set out how ORR will ensure that it is not the same individuals or team who reconsider the original decision.

We are happy to discuss in further detail any of the points raised above.

Yours faithfully

Phil Dawson
Regulation & Track Access Manager

Peter Swattridge
Head of Regulatory Economics
Network Rail

Natasha Frawley
Economist
Office of Rail and Road
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Dear Natasha

Network Rail response to ORR consultations on Open Access

This letter sets out Network Rail's response to ORR's three recent consultations on Open Access:

1. Implementing infrastructure cost charges for open access operators.
2. Guidance on the Economic Equilibrium Test.
3. Competition work on Open Access.

Our response makes some general comments on the consultation documents, and then addresses ORR's specific questions in the "Implementing infrastructure cost charges…" consultation. We consider that many of the issues that ORR discusses in its consultations are mostly relevant to existing and aspirant Open Access (OA) operators and franchised passenger operators, rather than directly relevant to Network Rail. Consistent with this, our response is brief.

General comments

The following section sets out a number of general comments from Network Rail on ORR's collection of consultations.

Roles and responsibilities with regards to ORR's proposed assessments

ORR is not clear in its "implementing infrastructure cost charges" consultation who it expects to undertake the assessment of "substantial modification" and "interurban". We would be grateful if ORR could provide more clarity on this. Given the sensitivity of the outcome of this assessment, and the importance to aspirant and existing OA operators, we suggest that ORR undertakes these assessments itself.

Clarification on how the Infrastructure Cost Charge should be calculated

It would be helpful if ORR confirmed, algebraically, how the infrastructure cost charge would be calculated as this is not currently clear. This would also help us to fully understand the billing implications of the Infrastructure Cost Charge.

Guidance on the Economic Equilibrium Test (EET)

ORR sets out several potential information requirements that it may request from Network Rail, in its consultation document. We would welcome a further discussion with ORR about the kind of information it would expect to receive from Network Rail, and to what level of detail. For example, ORR notes that it may request an "assessment of impacts on capacity use". It would be useful to understand what kind of assessment ORR would expect in this

situation, so that we can be ready to respond to any information requests of this nature within ORR's specified timescales. This is especially true if ORR will require a detailed operational performance assessment from Network Rail, which is likely to take a long time to produce.

We would welcome further guidance from ORR about how the EET would be carried out where a franchise was due to be renewed during the time period in consideration for the commencement of the proposed new OA services.

We believe that it would be helpful for ORR to provide OA operators with greater clarity about what the EET will involve and how it will be assessed. For example, it is currently unclear how ORR would assess the "wider benefits" to consumers (other than noting that this is likely to be informed by the NPA test). We believe that this would help OA operators to plan their businesses.

Loss of FTAC income

There is a risk that Network Rail could lose Fixed Track (FTAC) income as a result of ORR's proposed changes for OA operators. This is because, now that FTAC is charged on a variable basis to franchised passenger operators, a reduced number of franchised passenger services would mean that Network Rail does not recover the required amount of FTAC. However, we consider this risk to be small as this lost income would only materialise in a specific set of circumstances:

- Additional OA services made certain franchised passenger services unsustainable, to the extent that franchised passenger operators could no longer run them; and
- DfT agreed that franchised passenger operators should no longer run these services (as these would likely have been tightly specified in the franchise agreement with DfT); and
- The reduction in franchise passenger operator services would have to happen during CP6.

Therefore, on balance, we do not consider that this will be a significant risk for CP6, but it should be considered for future control periods when it may become more relevant.

Next steps

It is not clear from the consultation documents how ORR intends to take its work forward on the Infrastructure Cost Charge. We would welcome clarity from ORR on what its proposed next steps are, and the associated timescales, with regards to this.

<u>Responses to ORR consultation questions – implementing infrastructure cost charges</u>

In this section, we set out Network Rail's response to each of the specific questions that ORR raised in its consultation on "Implementing infrastructure cost charges for open access operators".

ORR question 2.1: Do you have views on our proposal to add ICC income to revenue generated in the NPA test when assessing new (or substantially modified) interurban open access services?

Network Rail response: As noted in previous ORR consultation responses, we support ORR taking the infrastructure cost charge (ICC) income into account when assessing Open

Access proposals and recognise that including it in the existing Not Primarily Abstractive (NPA) test would be the easiest way of doing this. However, on further reflection, we consider that including the ICC income as revenue generated seems curious, as it is an additional source of income for Network Rail, and not revenue generated by the Open Access proposal. Instead, we consider that a better approach would be for ORR to redefine the purpose of the NPA test such that it is explicit that it assesses both revenue abstracted and income generated for the railway. Following such a redefinition, it may then be appropriate to include the ICC income within the test. Absent a reconsideration of the purpose of the NPA test, we consider that the proposed changes to the NPA formula could be thought of as not being consistent with the current purpose of the NPA test.

ORR question 3.1: Do you agree that the substantial modification definition is appropriate for determining if a modified service proposed by an existing operator is in scope to pay an ICC?

Network Rail response: Whilst we broadly agree with the categories of change set out in ORR's consultation, it does not appear that ORR has included any minimum threshold on any of these. This, therefore, means that any change to one of the proposed categories would be considered a substantial modification, when in fact the modification could be quite small. For example, it appears that a reduction in an existing OA operator's station calls would be considered a "substantial modification", as this would fall into ORR's category of a change in the number of stops. We believe that ORR should consider including a threshold in its definitions, such that small service changes are not inappropriately defined as a "substantial modification".

We consider that ORR should take a consistent approach to defining a "substantial modification" as set out in the "Guidance on the Economic Equilibrium Test" document. This would mean that an extension of the duration of existing access rights would not, generally, be considered a substantial modification for the ICC.

ORR question 4.1: Do you have views about our intention to define the interurban market segment in terms of station demand and minimum distance? Do you have views on the proposed passenger and distance thresholds?

Network Rail response: We support ORR's approach of trying to achieve a simple and predictable set of criteria for determining if an Open Access service is classed as interurban. We believe that a combination of distance and station criteria could work in terms of defining interurban services. However, we consider that ORR's proposed definition, especially the 2-mile radius criteria, is quite complicated and could be simplified (see our response to question 4.3 for an example).

We would welcome greater transparency of ORR's consultant's data used for the ability to bear work referenced in the consultation. It is not currently clear if ORR's proposed definition aligns to the services that ORR's consultants found could bear (i.e. afford) the ICC. With regards to the ability to bear, we also note that a service's ability to bear additional costs largely depends on the fares of that service. However, for rail services fares aren't always related to distance travelled. As ORR's definition uses mileage as a criteria, this may capture some Open Access services with low fares but high distances, which cannot afford the ICC.

ORR question 4.2: Do you have suggestions for other characteristics that could be used as potential parameters for the interurban market segment?

Network Rail response: In its consultation, ORR notes how important the peak / off-peak split is with regards to operators "ability to bear" the new infrastructure cost charges. However, ORR has not proposed any time-of-day or peak / off-peak definitions in its characterisation of "interurban". ORR may wish to consider whether this should be included in its definition of interurban, although we recognise that ORR may have purposely excluded this so as not to overcomplicate the definitions. If ORR does wish to consider this, we would welcome further discussions around how this could be billed through Network Rail's systems.

ORR question 4.3: Do you have views about the proposal to include all stations within a certain radius of busy stations within the interurban market definition? Do you agree with the proposed two-mile radius?

Network Rail response: ORR should be mindful of any unintended consequences of its proposal to create a two-mile radius around a 'busy' station, for example Open Access services proposing to terminate just outside of the two-mile radius, yet still clearly serving a busy urban centre. We recommend that ORR checks that its proposals do not result in this issue. An alternative approach could be for ORR to list a number of major towns and city, and then classify any station that serves that town or city as interurban (provided the stations were at least 40, 50 or 60 miles apart).

ORR question 4.4: Do you have views on whether ORR's discretion should sometimes be used when determining whether a new open access service is part of the interurban market segment? How could we exercise that discretion? Do you have views on what may be relevant guidelines for the discretion?

Network Rail response: We consider that ORR should have a clear policy for assessing "new" and "interurban" Open Access services that is predictable and straightforward. We do not consider that ORR applying discretion to its decision as to whether an Open Access service is "new" and "interurban" is consistent with the assessment being predictable and straightforward. We also note that there may be a risk that ORR is accused of undue discrimination if it uses its discretion in this decision-making process. For these reasons, we consider that it would likely be inappropriate for ORR to apply discretion in the definition of "new" and "interurban" Open Access services.

We are happy to discuss any of the above with ORR if that would be helpful.

Yours sincerely

Peter Swattridge

Head of Regulatory Economics, Network Rail

Rail Delivery Group

National Rail

BRITAIN RUNS ON RAIL

Rail Delivery Group

Response to ORR consultations on:

- Implementing infrastructure cost charges for open access operators
- ORR's draft guidance on the economic equilibrium test

Date: 14 January 2019

Rail Delivery Group response to ORR consultations on:

- Implementing infrastructure cost charges for open access operators; and
- ORR's draft guidance on the economic equilibrium test

Organisation: Rail Delivery Group

Address: 200 Aldersgate Street, London EC1A 4HD

Business representative organisation

Introduction: The Rail Delivery Group (RDG) brings together passenger train operators, freight train operators, as well as Network Rail; and together with the rail supply industry, the rail industry – a partnership of the public and private sectors - is working with a plan *In Partnership for Britain's Prosperity*[1] to change, improve and secure prosperity in Britain now and in the future. The RDG provides services to enable its members to succeed in transforming and delivering a successful railway to the benefit of customers, the taxpayer and the UK's economy. In addition, the RDG provides support and gives a voice to passenger and freight operators, as well as delivering important national ticketing, information and reservation services for passengers and staff. taxpayers and the economy. We aim to meet the needs of:

- Our Members, by enabling them to deliver better outcomes for customers and the country;
- Government and regulators, by developing strategy, informing policy and confronting difficult decisions on choices, and
- Rail and non-rail users, by improving customer experience and building public trust

For enquiries regarding this consultation response, please contact:

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[1] *In Partnership for Britain's Prosperity,* RDG (October 2017): http://www.britainrunsonrail.co.uk/files/docs/one-plan.pdf

Overview

1. This document outlines the key points from our members in response to ORR's consultations on implementing infrastructure cost charges for open access operators and ORR's draft guidance on the economic equilibrium test. The Rail Delivery Group (RDG) welcomes the opportunity to contribute to these consultations. We are content for this response to be published on the ORR website.

2. Open access operators (OAOs) have an important role to play in delivering new and/or alternative services to customers and increasing competition in today's railway. At the same time, there are significant costs associated with planning and delivering open access services. These services can also have a significant impact on existing operators and on competent authorities procuring services under public service contracts (PSCs).

3. It is therefore vital that there is sufficient clarity on how applications for access rights by OAOs will be judged, when and where infrastructure cost charges (ICCs) will apply and the level(s) of those charges so that all parties can plan their businesses with a sufficient degree of certainty.

4. It is also vital that any ICCs reflect the OAO's share of the fixed costs of the relevant infrastructure and that they are only paid to the extent that the profitability of each relevant service means that the OAO can bear the additional cost relating to that service.

5. The key points of the RDG's response are as follows:

    - we welcome the additional guidance provided in both consultations in a move towards increasing clarity, but have concerns in specific areas;

    - there is a concern with the proposed definition of the interurban market segment and that too much uncertainty remains around assessment of the impact of an open access service on the profitability of PSC services and the net cost for respective competent authorities. Both of these may impact on business planning for existing services and potential new open access services;

    - the definition of a substantial modification appears to capture relatively minor changes to existing services, which is likely to deter such changes to the detriment of passengers; and

    - we consider that these concerns could be addressed by clearer and, in some cases, more appropriate definitions and, subject to the comments below, by more work now on how any regulatory discretion would be exercised.

6. Our detailed points are set out below.

Implementing infrastructure cost charges for open access operators

Revised 'not primarily abstractive' test

7. Any comments RDG members may have on this will be included in their individual responses to this consultation.

Definition of a 'substantial modification' of access rights

8. We agree that relief from ICCs should be provided to existing OAOs for the entirety of CP6 unless there is a substantial modification of access rights. However, there is a risk that this introduces a perverse incentive to avoid making modifications to access rights in response to changes in consumer demand. This risk is minimised if the definition of 'substantial modification' is set at a point where the benefits of any modifications outweigh the additional cost of ICCs. If it is set lower than this, relatively minor modifications which would benefit customers are less likely to be made.

9. We are concerned that the proposed definition is too restrictive and would unduly disincentivise certain changes which would benefit customers being made. We consider that ORR should reconsider this definition.

Proposed definition of the interurban open access market segment

Proposed definition

10. We recognise that ORR is using the interurban open access market segment as a proxy for the ability of an OAO to bear ICCs for particular services. However, we consider that more work needs to be done in this area. We are concerned about the extent to which the current proposals reflect this ability to pay, for example by disregarding time of day and by using station demand and distance between stations. It would be useful to understand how well the proposed definition and various options would align with the ability to pay analysis. Any inconsistency between the proposed approach and ability to bear ICCs is likely to distort an OAO's decision as to which new services to develop (or which existing services to modify) or even mean that they are unwilling to invest in developing new proposals.

ORR discretion

11. We agree with ORR that a clear and specific definition of the interurban open access market segment is better than one with a discretionary aspect. Network Rail has indicated that it would be far better to amend the proposed definition so as to avoid the need for a discretionary element. Other RDG members see some benefit in ORR taking other factors into account in making a final decision on the ability of a particular service to bear an ICC where there are marginal cases. The major disadvantage with such an approach is that it has the potential to introduce significant uncertainty in the process, which will affect operators' ability to plan their businesses and put together proposals. It also risks adding significant delays to the process. We therefore consider that, if regulatory discretion is to be available, more work needs to be done now on what other factors could be considered, how they would be taken into account and how any remaining regulatory discretion would be exercised.

Process

12. We consider that ORR should clarify the process around ICCs. For example, it is not clear from the consultation document who ORR would expect to undertake the assessment of substantial modification and the interurban market segment.

ORR's draft guidance on the economic equilibrium test

Definition of a 'substantial modification' of access rights

13. We consider that it would be helpful for ORR to explore whether whatever definition is ultimately established in relation to ICCs (see our comments above) could be used for the EET or whether there are any impediments, legal or otherwise, to this.

Approach to assessing the impact on economic equilibrium

14. The draft guidance sets out many of the factors that ORR will consider when assessing the impact on profitability of services operated under a PSC and the impact on net cost for the relevant competent authority awarding the PSC. However, there is no indication as to how these factors will be considered and the level at which these impacts will be considered to be indicative or decisive of an issue with an OAO application. This leaves a significant level of uncertainty making it very difficult for both OAO applicants and existing operators to plan their businesses sufficiently and may be a significant deterrent to (potential) OAOs to develop proposals for new open access services. We consider that more detail needs to be provided on these issues and on how wider net benefits will be taken into account.

Transport for London

Transport for London
Palestra
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SE1 8NJ

Access and Licensing Team,
Office of Rail and Road,
One Kemble Street,
London,
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10th January 2019

Dear Sir/Madam,

Consultation on ORR's draft guidance on the Economic Equilibrium Test

This letter sets out our response to the ORR's consultation on the draft guidance it has issued for the Economic Equilibrium Test (EET). We are content for our response to be published and shared with Third Parties.

We accept the value that Open Access operators can bring in terms of opening up new markets for the rail sector, improving service quality and reducing prices. It nonetheless remains important that any adverse impacts they have on public sector rail services are mitigated, as far as is reasonable. This has been recognised recently by the ORR's policy decision to require open access operations that focus on the interurban market to contribute to fixed network costs.

We therefore support the rationale behind the EET. It is important that the test fully considers the financial impact of proposals on franchising and concessioning authorities as well as on operators.

Our main concern with the application of the EET is the lack of any substantive guidance on how the various factors covered will actually be evaluated. It is important that further clarity is provided here to give a greater level of certainty to all parties regarding how the EET evaluation will work. The reference to consideration of rates of return expected by operators and contracting authorities is useful in this regard, but requires further elaboration given the range of contracting models in use for rail services. The need for greater clarity is particularly important given the relatively short timescales for submission of information related to an EET and the diversity of information required.

Contrastingly the Not Primarily Abstractive Test is clearly focused and therefore straightforward to model and understand. It is important that the EET evaluation is described in a similar manner with clear guidance on how

information should be presented and how the results will be interpreted. Over time case law and conventions will doubtless evolve but it would be helpful for more clarity initially to ensure that the EET functions in an effective manner.

Yours sincerely,

Alan Smart,
Principal Planner – Rail Development,
Public Transport Service Planning,
Transport for London.