

Phil Dawson
Regulation and Track Access Manager
East Coast Mainline Company Limited
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24 April 2014

Dear Phil,

Great North Eastern Railway Ltd (“GNER”) S17 Application

Thank you for your response; this is Alliance Rail Holdings (Alliance) response on behalf of GNER. For clarity GNER is a subsidiary company of Alliance Rail Holdings Ltd.

Revenue Abstraction

In your response you focus heavily on the amount of abstraction you believe will occur as a result of the introduction of GNER services. As I am sure you are aware, the economic test undertaken by the Office of Rail Regulation (ORR), the Not Primarily Abstractive (NPA) test, is used to gauge any impact on the Secretary of State’s funds. The NPA test does not just take into account the amount of revenue a new service will abstract. It balances this against the likely new business that would be generated and other compensating economic benefits. GNER’s application comfortably passes the NPA test and evidence of this will be provided to the ORR as part of the complete business case.

It is incorrect to state that our application relies on a Statement made by Stephen Hammond MP. The statement is included to support a widely held view of the value and benefits that commercial open access services bring. You quote the governments Command Paper ‘Reforming our Railway’s: Putting the Customer First’ Paragraph 4.42, I think it is therefore important to point out that this paragraph begins with the following statement: *“Government values the benefits of competition that open access can bring, such as greater choice and lower fares for some passengers.”*

Whilst it may not have been government policy then to support an increase in open access competition the statement you quote can have no impact or influence over an increase in open access services. I am sure you are aware that under EU law the ORR *“shall not seek or take instructions from any government or other public or private entity when carrying out the functions of the regulatory body...”* (Directive 2001/14/EC Article 30 – now Article 55 2012/34/EU, Clause (3) Paragraph 4).

Capacity

Alliance's position in relation to capacity is that capacity exists as it was funded by way of "The CP4 Delivery Plan, Programme 18 – East Coast Main Line improvements". The output of which is as below:

Output

These schemes deliver both the HLOS passenger kilometre specification for strategic route 8 and the London capacity specification for the East Coast.

The following will be provided (the baseline being the December 2008 timetable):

- *up to two additional freight paths per hour between Peterborough and Doncaster;*
- ***up to one additional long distance high speed passenger path per hour off peak (note: currently there are 7 paths in many off peak hours);***
- ***up to two additional long distance high speed passenger paths in each peak hour; and***
- *operation of up to ten outer suburban services per peak hour, with up to six of these being 12-car formations, subject to calling pattern."*

Network Rail and ORR have confirmed that the May 2011 Timetable recast was not reliant upon this programme of works. Alliance concludes that the capacity is available as a result of the CP4 Programme 18 schemes the value of which was just under £700m.

In addition during CP5 Network Rail has been funded by ORR in relation to the East Coast Main Line (ECML) Connectivity Fund. This is £247m to improve capacity and journey times. Alliance is confident that the £900m of funding on ECML schemes during CP4 and CP5 will deliver the stated benefits in Network Rail's Delivery Plan. If it does not then one must question the value to the taxpayer, the government and the rail industry.

Alliance believes that following a timetable recast to optimise the network, capacity will exist to accommodate all of our proposed services and we are working with Network Rail to prove this capacity. Should capacity still remain constrained we would look to the ORR to explore the use of the provision set out in Paragraph 18(5) of the Access and Management Regulations to make better use of the network.

Access Charges

You again state that all operators on the ECML should pay access charges on the same basis and that the charges should reflect the economic value of the capacity used. I urge you to read the decision made by Mr Justice Sullivan in the case of (the then) *GNER and the*

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ORR & others [2006] to better understand the actual legal position of the access charging regime.

Open access and franchised operators both pay the variable usage charge. This charge is the best measure of the costs directly incurred by Network Rail as a result of the specific train service being operated. In addition franchised operators pay a fixed access charge, which is a mark-up paid over and above the costs directly incurred by Network Rail to allow it to obtain full recovery of its costs.

Fixed access charges are a residual figure calculated by deducting the variable usage charge and network grant from Network Rail's total revenue requirement, and so they are an "artificial construct", as stated by Mr Justice Sullivan in the case of (the then) GNER and the ORR & others [2006], and do not represent the actual cost directly incurred by Network Rail in maintaining a specific section of route a specific train service operates over.

The former Rail Regulator Tom Winsor explains in plain English terms why Open Access does not pay the fixed access charge in his written statement in GNER and the ORR & others [2006]. He identifies that the fixed access charge is paid by franchised operators who act merely as conduits for government money destined for the infrastructure manager. Open Access operators cannot pay the fixed access charge as they receive no income from government and can therefore not act as a conduit for government money.¹

The fixed track access charge forms part of the industry money go round and reduces the network grant, but it need not be paid by franchised operators as it could be paid via the network grant. Alliance therefore argue that as the fixed access charge confuses people in the industry and is seen as unfair, then it is time to remove it and pay this as Network Grant.

It is clear that any changes to the current access charge regime would also require a change in the way in which Open Access operators are granted access to the network. For example barriers to entry such as the NPA test would need to be removed and Open Access operators granted equal opportunity to operate services.

Draft Track Access Contract

Alliance believes that a 15 year track access contract is fully justified by the significant level of investment proposed in the application. We will be providing the commercial justification to ORR in respect of securing a long term track access contract based on the levels of investment.

Finally, in your letter you raise specific questions which are answered below:

¹ Tom Winsor's written statement in GNER v ORR and others 2006

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Q1: How much revenue abstraction does the proposal require to be viable?

Alliance's proposal comfortably passes the NPA test and this work will be shared with the ORR.

Q2: If Alliance was only granted rights for the Cleethorpes services, would this be viable in its own right?

This question is not relevant. Alliance has applied for the services detailed in the Form P submitted as part of the application.

Q3: East Coast notes the ORR's Moderation of Competition – Final Conclusions “*The Regulator acknowledges that competing services that are primarily abstractive of incumbents' revenue without compensating economic benefits – cherry-picking services – are undesirable*”. Given that the Leeds <> London King's Cross flow is the second largest flow in terms of revenue in the UK, please explain in full how your proposal to run services between Leeds and London King's Cross does not involve cherry-picking.

As you detail in your question, cherry picking services are those which are primarily abstractive without providing compensating economic benefits. The proposed services comfortably pass the NPA test and as acknowledged by the government, “*offer a service that will work well for both customers and the public purse*”. It also brings further economic benefits in the form of over 150 employment opportunities and significant private investment in the infrastructure.

The proposal clearly opens up new journey opportunities, promotes a new station, and provides significant passenger benefit through competition that is currently not available. The proposal can in no way be deemed a cherry picking exercise.

Chief executive of the ORR Richard Price recently commented: “*Passengers are increasingly the main funder of railways and must be central to developing its plans for the future*” – I think it is worth noting that passengers, the biggest funders of the railway, are not mentioned at any time in your response.

Yours sincerely,



Ian Yeoward
Managing Director