

Annex D: The five stages we use to conduct the ‘not primarily abstractive’ test

We would expect to apply the ‘not primarily abstractive’ test to:

- (i) a new open access service which would compete with franchised services and so impact on the public sector funder’s budget;
- (ii) a new franchised service which would compete with an existing franchised service, where we would expect to focus the test on areas where the competing franchised services are operated on behalf of different funders or where for some other reason there are particular concerns over the impact on a funder’s budget; and
- (iii) a new service, which might be open access or franchised, which would compete with an existing open access service and which, if it caused the existing open access operator to withdraw from the market, could reduce overall competition on the network.

We also believe that there could be circumstances where we would apply the test when one franchisee proposes to increase the level of competition against another franchisee (which might include, for example, an increase in the number of services or station calls) in order to help inform us whether it would be likely to be wasteful competition.

Once a service has been established, an application to approve an extension of the duration of access rights does not amount to a new competing service. We would not therefore expect to reassess such services against the ‘not primarily abstractive’ test.

Our five stage test is as follows:

- (a) Stage 1 will use standard industry models of growth and patterns of changes in demand, notably the passenger demand forecasting handbook (PDFH¹) and MOIRA² software, to make an initial broad estimate of the likely level of revenue abstraction and generation. The current version of MOIRA only allocates demand based on timetable factors such as journey time and speed. Where material and practical we would expect to take explicit account of the following factors:

¹ The PDFH summarises existing knowledge on rail passenger demand forecasting and is based on information gained in a large number of research studies. It gives clear recommendations that enable users to forecast changes in demand in light of anticipated changes in circumstances.

² MOIRA is a computer model which models the effect of changes in rail timetables on passenger demand and passenger train operator revenue. It is consistent with the PDFH and may be used in tandem with that document

- (i) differential dedicated fares on new competing services;
- (ii) service quality and marketing, for example the use of different rolling stock on new competing services;
- (iii) crowding: where new services would reduce existing crowding or the level of crowding on new services was likely to be different to that on existing ones;
- (iv) large time savings: where time savings are large and the existing rail service is poor (for example if the new service provides a direct service where none previously existed) In these circumstances, and where data is available, we would also expect to take account of railheading.

In our assessment of these impacts, where appropriate and practical, we would expect to build on the approach that we have used previously. For example in more detailed cases we would expect to take into account the approach taken by MVA for East Coast Main Lines services³ which used higher demand elasticities for large time savings.

(b) Stage 2 will review the broad estimate produced in stage 1 in the light of information provided by:

- (i) the operator proposing the new competing services;
- (ii) incumbent operators potentially affected by the new competing services;
- (iii) the DfT, Transport Scotland and Welsh Assembly Government; and
- (iv) any other interested parties, such as Transport for London, PTEs, Passenger Focus and London TravelWatch.

To inform this assessment, the operator proposing the new services will be asked for its business plan, including:

- (i) details of the forecast revenues and costs for the proposed services;
- (ii) details of the forecast benefits to passengers using its services;
- (iii) details of the proposed fare structure and pricing policies; and
- (iv) forecast demand growth on the route (i.e. the level of growth in overall rail passenger usage, as opposed to the impact on incumbent train operators).

The information provided by an incumbent operator is likely to comprise analysis illustrating the impact on its business, including the expected levels of abstraction. It may also provide demand forecasting analysis that is on a different basis or uses a different approach to that used by us in stage 1, if it considers this is likely to provide a more accurate estimate of likely impacts.

³ Assessment of alternative track access applications, MVA, January 2009. This document can be accessed at: http://www.rail-reg.gov.uk/upload/pdf/ecml-cap2_MVA_finrep_red.pdf.

The realism of any forecasts will be assessed and we may request meetings with, in particular, the applicant and the relevant franchising authority to inform this assessment.

(c) Stage 3 will use readily available benchmarking and survey information from any comparable situations elsewhere on the network and, where available, from relevant independent surveys in order to refine the estimates produced by stages 1 and 2. Over recent years, a number of new competitive services have been introduced. Information from these services, where applicable to the situation being considered, will be used to refine earlier estimates.

(d) Stage 4 will consider the likely impact that the proposed new services would have one to two years after their introduction, on the basis of available relevant information, including information from the applicant, the franchising authority and incumbent operators. This is to identify material impacts that would not occur immediately on introduction of the new competing services. The likely effect would be a reduction in the estimated proportion of revenue abstracted from existing services, as more people who previously did not use rail become aware of the new services over time. This so-called 'ramp-up' effect is common with the introduction of new services that have different characteristics from those of an incumbent's services. On the other hand, this stage may also consider circumstances in which abstraction may increase (for example, if the operator of the new services were to change its pricing policy). Where relevant we would expect to use ramp-up factors taken from the latest version of PDFH.

(e) Stage 5 will consider other relevant factors. Stages 1 to 4 will provide a quantitative estimate – almost certainly in the form of a range - of the revenue from the proposed new services that might be expected to be new to rail (i.e. generated revenue rather than abstractive). However, this figure needs to be put in context and other relevant factors may need to be assessed, including:

(i) the degree of confidence that can be placed in the various estimates derived in stages 1 to 4 (for example, whether all or most of the evidence points towards a level of abstraction falling within a narrow range, or whether there is considerable uncertainty about the likely revenue effect);

(ii) whether the levels of abstraction and generation are relatively evenly spread across the flows under consideration; and

(iii) where a new service competes with an open access service - whether this would cause the open access operator to withdraw from the market, reducing competition on the network.

Having completed this five stage process, we will then consider whether the proposed rights are primarily abstractive in nature. There will necessarily be a large degree of judgment involved in this decision. We will need to strike a balance between a number of our statutory duties, in particular to promote: the use of the railway network; competition for the benefit of rail users; whilst enabling persons providing railway services to plan with a reasonable degree of assurance and having regard to our duties in relation to funders.