

Dear Sirs,

The following are my comments on your Consultation Document.

Unfortunately I have found it impracticable to format my comments as responses to your individual questions, but hope that this will not preclude you from giving them your consideration.

Comment

1. It is evident that the present rules used to determine the acceptability of proposals for additional services to be provided by OAOs are quite onerous which has contributed to a very limited amount of competition from such operators.
2. Assuming that competition results in improvement to services provided to the public (and normally this is the case), it is therefore welcome that ORR is now seeking to enhance the opportunities for competition both from OAOs and from other franchise holders. However as the ORR consultation document notes it is essential that such competition does not result in an overall deterioration (i.e. increase) in the amount of funding support required from government.
3. As is presently the case with Option 1, the additional options (Options 2 & 3) will continue to most probably deliver increased competition only on routes where the operator has a realistic expectation of acceptable profitability in their own right. Consequently any additional competition will continue to be in respect of longer distance Inter-City routes, though not necessarily confined only to routes to and from London.
4. The great merit of the present Option 1 is that it is simple; the only requirement is for the OAO to agree with the ORR that the proposed service will pass the NPA test and beyond that the OAO has certainty as to his access charges. The new Options 2 & 3 will require a much more complex set of determinations and calculations in order to advise what the access charges will be and this, as the Consultation Document acknowledges, will generate a greater level of uncertainty. It also has to be assumed that in many cases franchise holders may wish to challenge any determination which they consider to be favourable to the OAO.
5. The Consultation Document does not appear in Options 2 & 3 to place any clear limitations upon potential operators other than a requirement to pay the additional access charges. Whilst it is suggested that the additional charges would reflect the additional abstracted income above the present 0.3 ratio in practise it will be very difficult to determine the appropriate charging level in advance of the service operating for a period of time. The Consultation Document states "4.14. We do not see any practical alternative to setting mark-ups on the basis of forecast volumes, rather than actual data." This is true and unavoidable, but could result in one of the following scenarios –
 - a. The additional charges are set high and the potential competitor decides not to compete.
 - b. The additional charges are high, the competitor accepts the deal but finds in a relatively short time that the business is fundamentally unprofitable and therefore he terminates the service.

- c. The additional charges are low such that the competitor could operate a highly profitable route already served as part of a franchise and engage in direct “head to head” competition with the belief that he has a fundamental cost advantage of not being involved with either the less profitable parts of a franchise nor having to pay any franchise premium. This results in the franchise holder losing very significant income.
6. Any potential competition is constrained by the need for Network Rail to agree that there is physical capacity on the proposed route to allow operation of the service. Evidence suggests that Network Rail takes a very conservative view in this respect and it may be that the ORR needs to challenge this view in respect of future proposals.
7. A franchise bidder, if aware of such potential competition, would either enter a much more conservative bid (lower premium or higher subsidy) or qualify his tender to require the inclusion of a financial claw back in the event of such competition. Either of these would probably result in a less favourable financial outcome for the government.
8. Competition on a direct “head to head” along the same route with similar calling patterns could easily lead to an unstable situation in respect of the level of services provided by each service provider and to frequent changes prices at which various services are offered. The franchise holder may resort to predatory (below cost) pricing on the route where he is subject to competition with the aim of driving the competitor off.
An example of this might be Leeds – Kings Cross which is the most profitable element of the East Coast Franchise. It is entirely possible that competition would increase total demand so that a competitor could legitimately assert that his service was not entirely abstractive, yet the outcome could well yield an unstable situation and result in a negative outcome for passengers and / or the government. Would the ORR potentially support such a service?
9. A more attractive form of competition would be where there are two competitive services between major city pairs, but they follow substantially different routes between the cities. This already occurs in the case of London – Birmingham which is served both by the West Coast Mainline and the Chiltern franchises. There are a considerable number of other potential such services. Some possible examples are –
 - a. London St Pancras – Manchester via Derby
 - b. London St Pancras – Leeds via Sheffield
 - c. London Euston – Edinburgh
 - d. London Kings Cross – Glasgow via Edinburgh
 - e. London Waterloo – Bristol via Guildford
 - f. Cardiff – Leeds via Shrewsbury and Manchester.
 - g. Bristol – Leicester using future East – West rail link.
10. Services as described in 9 above have a number of merits –
 - a. They provide a modest level of competition to some key Inter-City routes. However given that they will in most cases have a considerably longer end to end journey time the level of competition will not unduly threaten the franchise holder, but could provide some pressure on pricing.
 - b. There are presently many journeys between major towns & cities (excluding London) where the rail journey time is excessive due to poor connectivity. Services such as those listed above have the potential to greatly improve (non-London) connectivity and hence grow the market.

- c. Such services would positively contribute to the concept of the 7 day railway, by providing alternative services already in place.

There is however an added complexity associated with assessing the appropriate level of Access Charges to be applied (under option 2 or 3). The abstraction will be a combination of relatively small levels of abstraction from multiple existing services and it will be extremely difficult to assess these abstractions with any degree of accuracy.

11. Conclusions and suggestions from the above are –

- The ORR initiative to increase competition is appropriate.
- It is unlikely that these proposals will result in additional competition on short distance urban services or on rural services.
- The proposed options 2 &3 involve much more complex assessment and calculation than the existing option 1. It may therefore be that a potential OAO may be discouraged from developing proposed services given the significant uncertainties and risks associated with these new options.
- The ORR could mitigate this problem by both indicating the types of services it particularly wishes to encourage (possibly with examples) and give an indication of the potential levels of access charges it is likely to impose.
- The ORR should consider developing a remedial mechanism to apply in the case where it becomes evident that an open access service in operation is generating revenues and /or abstraction levels which differ significantly from those assumed when agreeing the access charges under which the service was authorised.
- The ORR needs to provide some assurance to franchise bidders that their profitability will not be unduly undermined by an OAO after the franchise has been agreed. This could be achieved by either (or both) indicating up-front likely relevant OAO services and / or providing a financial mitigation formula for the franchise in the event that an OAO service has a significant and unforeseen impact.
- The ORR should make it clear as to which types of additional services beyond their franchise remit existing franchise holders would be allowed to operate under these rules. In reality some of the routes referred to in 9 above may only be attractive to a franchise holder rather than to an independent OAO.

Yours sincerely,

Chris Fox