STAGECOACH GROUP

10 Dunkeld Road
PERTH
PH1 5TW
Scotland

T: +44 (0) 1738 442111
F: +44 (0) 1738 643648

stagecoachgroup.com

Phillip Willcox
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

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Dear Phillip

**PR13 – On-rail competition: Consultation on options for change in open access**

This response is submitted on behalf of Stagecoach and its two train operating companies, Stagecoach South Western Trains and East Midlands Trains, and addresses the questions in the above consultation document.

We support competition in principle and ORR's view with respect to reducing barriers to entry and encouraging volume increase incentives. However, the proposals for enhancing on-rail competition in the consultation do not seem to fit with the franchising policy promoted by the DfT. The fixed service specification in DfT's franchises makes it very difficult for TOCs to respond to competition and the fixed premium leaves franchisees very exposed to revenue loss from abstracted revenue. Furthermore, the current franchise specifically forbids a franchised operator from responding to competition by restricting the geography and routes over which the franchisee can operate. Moreover, many franchised TOCs are in revenue support and therefore do not retain 100% of farebox revenue generated by a new service, so should such a franchised operator wish to exploit the same opportunity as that identified by the open access operator, they would not be able to do so on a level playing field.

To promote further competition as in accordance with the proposals in the document would cause bidders for franchisees having to guess the level of open access competition and make an allowance in the revenue line. The recent Stagecoach bids for both ICEC and ICWC contained allowances of tens of millions of pounds for the provision of uncertainties caused by such competition, which led to reduced premia and therefore reduced income to DfT. Nonetheless, it is very difficult to estimate this financial sum accurately and it may lead to either a loss of premium to the government or a greater risk of failed franchisees.

Open access operators provide services purely on a commercial basis and are likely to be attracted to the main intercity routes as services on these routes are more profitable, especially at peak times. A better way to introduce competition on these routes would be to offer a number of groups of train paths as packages for the open access operators to bid for as proposed in the MVA/ ITS 2011 report and supported in the ATOC and Stagecoach responses to ORR's 2011 consultation (as listed on ORR website at http://www.rail-reg.gov.uk/pr13/consultations/orr017.php). For example, one 'bundle' could be one path an hour from Kings Cross to Leeds and one path an hour from Kings Cross to Newcastle, while another could be an hourly fast path to Edinburgh (and beyond). These would replace the existing franchised operator paths on the route. This approach would provide disciplines on

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open access operators not to simply 'cherry pick' the profitable services along the intercity routes. However, this would require in the removal of franchised services on these routes.

Below are our responses to the questions in the document.

**Q1. Do you agree that we have identified the key barriers to open access competition? Do you consider that the steps we are taking will help to address these barriers or that there are other actions we should be taking? Do you agree that, given the plans for other work outlined above, the remaining barriers imposed by the NPA test are important?**

We acknowledge ORR's view that the existing processes for open access operators to run passenger services could be improved to create more opportunities. However, as previously mentioned, it is likely that the open access operators would be attracted to those parts of the network that are profitable and full. This would not work across all three broad sub-sets of the rail market i.e. commuter, regional and inter-city, as the regional routes rely heavily on subsidy and the commuter routes need a single guiding mind to provide a reasonable service for all commuters on a capacity-constrained network.

We agree with paragraph 2.17 that government franchising policies are an important barrier to greater open access. Any revision of open access rules should be carefully considered in the context of government's franchising policies so that it is in alignment with franchised operators. In particular, this should include a feedback loop of compensation for abstracted revenue to franchised TOCs to enable open access and franchises to co-exist and to give TOC bidders the confidence to bid a premium line without worrying about significant abstraction from open access operators.

**Q2. What implications do you think that industry developments such as ERTMS, electrification and changes in EU law could have for our approach to on-rail competition? Are there other developments that could have an impact on our approach?**

Innovation and electrification are positive steps and should assist with volume enhancements. We do not anticipate the changes in EU law would have a significant impact on the ORR's approach to on-rail competition, as we do not believe that there is appetite on the continent for change e.g. Germany.

There are certainly other developments that could have an impact on this approach, for example, platform availability to improve turnaround times, installation of additional lines, changes to signalling, junction re-modelling / grade separation and possibly re-casting of timetables to release additional capacity etc. Extra capacity provided by ERTMS is likely to be absorbed by franchised operators, freight operators and open access operators fairly quickly. Moreover, technical developments such as ERTMS will increase the cost of rolling stock and hence the cost of entry for new operators.

**Q3. What are your views on Option 1? If we were to retain the current NPA test and structure of charges for open access what effect do you think changes to the economics of the railway and to capacity would have on the scope for and levels of**

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**open access competition? Do any factors other than those listed above favour (or not favour) Option 1?**

Option 1, the status quo will not have any effect on the scope for and levels of open access competition, although changes to the economics of the railway and to capacity may give new opportunities. Open access will only be feasible where there is sufficient capacity, but this is most likely to be available on routes where the business case for open access is more marginal.

**Q4. What are your views on Option 2? Should the mark-up be calculated on the basis of 100% of excess abstraction? Do any factors other than those listed above favour (or not favour) Option 2? What do you think of the feasibility of building a commercial case based on policy as described here? What changes/guarantees/mitigations would be needed to make this work?**

It seems right that the mark-up is calculated on the basis of 100% of excess abstraction, unless there are persuasive arguments for it to be lower.

Paying a mark up as an additional charge to offset the current limitation of the existing NPA test would create an opportunity for open access applications that fail the NPA test as per the current approach. However, the mark-ups would be received by Network Rail rather than funders directly and there is no guarantee that this will filter back to franchised operators who would have suffered from the allocation loss.

**Q5. What are your views on Option 3? What do you think of the feasibility of building a commercial case based on policy as described here? Are there any key practical or other issues that we have missed?**

Option 3 is very similar to Option 2, but comprises more complex calculations. Whilst both options are similar, it would be more practical to choose a more simplistic option over a complicated option in respect of the implementation of the process.

**Q6. Do you agree that the process described would be appropriate under Options 2 and 3? If not, what changes would you make and why?**

The process described in the document appears reasonable. Consultation is key and franchised TOCs which are impacted by the OAO must be given a voice in this process.

**Q7. Do you agree with the approach to estimating mark-ups, particularly the use of generation and abstraction forecasts to decide whether mark-ups should be applied and, in the case of Option 2, the size of the mark-up? Should OAOs be able to appeal the mark-up in the light of subsequent data?**

In practice, it is difficult to estimate the level of abstraction accurately particularly when considering long term forecasts. A way of dealing with this uncertainty could be to have annual wash ups in a similar fashion to those used for example EC4T charges. We do not support the idea that OAOs have the right to appeal the mark up in light of subsequent data as this would become a one way process, i.e. the OAO would only appeal in the event that the mark up was too high.

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**Q8. Do you agree that no mechanism should be introduced to address Network Rail's additional revenue through mark-ups? If not, what mechanism should be used?**

We believe that a mechanism has to be introduced to address Network Rail's additional revenue, but we do understand the complexity of implementation and subsequent operation of such a mechanism. It is essential that as part of the development of a mechanism it is recognised that franchised operators affected by abstraction must be compensated. By having such a mechanism funders might benefit through a reduction in their need to fund Network Rail and/or through less risk adjustment in franchise bids.

**Q9. Do you consider that, under any of the options considered in this document, the profile of mark-up payments should be tailored so as to address concerns over the ability of open access operators to pay in the early years of new services?**

There is no basis for any profiling because the abstracted part of the revenue transfers to the OAO immediately through ORCATS allocations. The generated revenue will build up slowly but this is no different to any other start up company which has to fund itself through a build up period. We do not want to see OAOs generating large profits in the first few years and then exiting the market when the mark up reaches a percentage that reduces the OAOs profit below their minimum desired return. At this point they could move their rolling stock to another part of the rail network and repeat the process.

**Q10. Does the review of mark-ups at periodic reviews cause problems for OAOs' planning of their operations?**

It is likely that this would cause uncertainty for OAOs, however as long as they are aware that their will be periodic reviews then they can allow for this in their long term planning.

Yours sincerely,

**Sam Gibbins**
**Track Access Manager**
**Stagecoach South Western Trains Limited**
**On behalf of Stagecoach Group plc**