East Coast Main Line Company Ltd: Response to ORR Consultation, "The potential for increased on-rail competition"

1. Executive Summary

1.1 East Coast fully recognises the benefits to customers and business that is generated from fair and open competition. We agree that it has the ability to drive down cost and therefore price to the consumer and it can result in greater responsiveness by suppliers to customer needs.

1.2 We welcome the opportunity for informed debate regarding the potential for increased on rail competition. However, we consider that the ORR's consultation document has not taken into account the full competitive environment in which UK rail operates, including non rail competition and in the case of discretionary travel, competition for consumers' disposable income.

1.3 In this response we have sought to highlight considerations which are not fully reflected in the consultation paper such as fair and open competition, the opportunity cost of competition and the pressure on franchise bidders to reduce costs.

1.4 We also consider there are other issues, which require to be addressed before ORR can formulate a policy for increasing on rail competition. These include the political and social requirements of the UK railway, taking into account the continued support of the taxpayer and the impact greater on-rail competition would have on the funds available to the Secretary of State.

1.5 We also consider that some of the ORR's statutory duties have not been reflected in the consultation document e.g. "the development of an integrated system of transport of passengers and goods", "to protect the interests of users of railway services", "to promote the efficiency and economy on the part of persons providing railway services" and "to have regard to the interests, in securing value for money…of persons providing railway services, of the persons who make available the resources and funds of the general public".

1.6 We also suggest that ORR considers the success or otherwise of competition in the bus market comparing the growth in London, where it is regulated, and elsewhere.

1.7 The UK passenger rail business is complex being a mix of profitable services and socially desirable services. It is also a mix of services being provided by differing operators which are sometimes competing and in other cases complementary. The taxpayer continues to provide substantial support for network benefits and deserves appropriate consideration. An increase in on-rail competition may result in competition in the high revenue markets, but an increase in total costs and loss of service provision elsewhere.

2. Introduction

2.1 East Coast welcomes the opportunity to respond to this consultation. This response focuses on the experience of on-rail competition on the East Coast Main Line. We also refer ORR to our response to the previous consultation, "ORR review of access policy" January 2010. Our response is attached as Appendix 1.

2.2 We support the need for the industry to meet the value for money challenge and we note ORR's statutory duty, "to promote competition in the provision of railway services *for the benefit of users of railway services*" (Our italics). We fully support the normal economic theory that fair competition can lead to improvements in efficiency and cost thereby leading to reduced prices, and also ensure greater customer responsiveness from suppliers.

2.3 Our response focuses upon:

- The effect of existing competition
- Fair competition
- The opportunity cost of competition
- Franchised operator costs
- The MVA Case Study

3. Existing Competition

3.1 The consultation document is clear that it does not consider competition that TOC's face from other modes of transport. We request ORR to re-consider this, both in terms of reviewing the consumer benefits that off-rail competition has already achieved, and the risk that further on-rail competition could make rail less competitive against other modes.

3.2 Over 80% of East Coast's business is for travel to and from London. East Coast competes with flights between London and Leeds/Bradford, Durham Tees Valley, Newcastle, Edinburgh and Glasgow. In addition East Coast competes with private car and coach travel which is able to use the M1, A1 and M11 routes. East Coast is also experiencing competition in relation to its business market from alternative methods of communication, including video conferencing and similar software solutions.

3.3 As only 3% of East Coast's business is commuting, the remaining 97% can be said to be discretionary. Nationally UK rail only has around 7% of total passenger-km.

3.4 In terms of the leisure market, East Coast is competing for consumers' disposable income and is therefore competing with valid substitutes, such as cheap flights from regional airports to alternative destinations and even non travel options of consumer choice.

3.5 Unlike on-rail competition, our off-rail competitors are often more fleet of foot and able to adjust their service offer. Off-rail competitors arguably have greater scope and competitive ability than on rail as they have greater ability to introduce and change products, routes and capacity. Examples include Stagecoach's "Megabus" and airlines switching capacity when the railway is disrupted by engineering work.

3.6 East Coast's commercial strategy is to generate demand for rail travel and to aggressively compete with and win market share from our off-rail competitors. In order to achieve this, East Coast and its predecessors have competed on price, frequency, journey time, ambience and customer service. In addition East Coast has responded to customer demand through innovations such as on board WiFi and at seat meal offers, specifically directed at attracting customers away from competitors. We stress that these benefits have been offered across our network, not just where we experience on-rail competition.

3.7 East Coast competes with other train operators at all its core stations with the exception of Newark. A summary of on-rail competition is attached as Appendix 2. It also competes across its whole route with off-rail competition which is a far greater impetus than on-rail competition. In relation to the East Coast Main Line we suggest that the normal customer benefits of fair competition have already been delivered as a result of East Coast operating in a competitive environment.

3.8 In response to this competitive environment, since privatisation, the franchised operator has increased service provision from 100 trains per day on weekdays to 155 whereas open access has increased service provision from 0 to 28. In terms of additional seats the franchised operator has provided an additional 29,700 seats per weekday compared with 7,840 by open access.

4. Fair Competition

4.1 The consultation document highlights that fare increases have been lower on Hull Trains and Grand Central compared with flows with no competition. (Para 3.10 and 3.11) We also note that the MVA analysis shows that both these companies have higher unit costs (MVA Para 2.6.9). It is East Coast's view that a level playing field does not exist between open access and franchised operators. In the case of a premia paying franchise, the fares charged which are mainly (but not all) set by that franchisee cover the operator's costs, including the fixed charge paid to Network Rail and the premia. An open access operator shares in the interavailable revenue which is set to recover costs which it does not incur. Therefore it is able to cross subsidise its dedicated fares from the excess profits it makes from the interavailable revenue. This together with the full allocation of ORCATS revenue from day one of its operation, effectively benefiting from the goodwill and market share of existing operators is, in effect, a considerable subsidy.

4.2 It is East Coast's understanding that a new competing service can pass the ORR's "Not primarily abstractive test" with a generation : abstraction ratio of 0.3. This effectively means an open access service can abstract up to 77% of its revenue from a near guaranteed source. We suggest to ORR that without this near guaranteed source of income neither Hull Trains nor Grand Central would have commenced operations as a significant part of their income came from ORCATS allocations at Doncaster and York respectively.

4.3 It is noticeable that the open access operator that did not appear to have a significant amount of its revenue "guaranteed" (Wrexham and Shropshire) has ceased business.

4.4 Whilst East Coast is mindful of legislation on access charging and the determination of the High Court in 2006, the combination of sharing the interavailable ticket prices, which are predominantly set by the franchisee whilst not paying the same costs, and the revenue: abstraction ratio, results in a open access operator on the ECML having a cost advantage in the order of [XX] per path per annum. We consider this to be sufficiently large to distort the market. In order to address this we suggest that where an open access operator shares the interavailable revenue it should pay a "mark up", as envisaged by the legislation, which is set to restore the balance of efficient costs between open access and franchised operators.

4.5 We also ask ORR to consider the impact on competition for the market when the owners of the two open access operators on ECML are also active owners and franchise bidders.

5. Opportunity Cost of Competition

5.1 On a route with limited additional capacity such as ECML it is likely that there will be an opportunity cost caused by the allocation of scarce capacity. East Coast's customers have suffered loss of benefits due to on-rail competition on ECML. These include:

5.2 A seventeen month delay in the implementation of the Leeds Half Hourly service as a result of a competing application for capacity. Between December 2005 and May 2007 the loss in services to Leeds (the UK's second biggest flow by revenue, and a flow that competes with an airport and motorway) was 12 trains a day. The competing service which delayed the implementation of the enhanced Leeds service was 6 trains a day which did not, in the event, commence service until December 2007;

5.3 A five month delay in delivering the "SLC 2" timetable by East Coast. Between December 2010 and May 2011 there was a loss of 19 trains a day in addition to the benefits of a standard hour timetable and improvements in frequency and journey time, as a result of competing applications. In this case the successful competing application was for 6 trains a day between Bradford and London;

5.4 East Coast's current application to operate an additional 12 services a day between London and York is currently being contested by a new aspirant operator. It is not known whether this will introduce delay;

5.5 The loss of the development by the then franchisee of the electrification of Leeds – Colton Jn and Hambleton South Jn together with the building of a Parkway station at Micklefield. In addition to the benefits to ECML this scheme had "7 day railway" benefits and potential benefits to local passenger services and other operators. It would have been an excellent pre-cursor to any decision on Trans-Pennine electrification. Using Green Book appraisal methods, Network Rail calculated the 30 year NPV to be in the order of [XX]. This development was lost due to ORR's decision to grant access on the ECML to a competing operator for 6 trains a day.

5.6 In coming to a view on the value of the competitor services, the abstractive nature of those services must be taken into account. As a franchisee cannot abstract from itself and the DfT requires positive business cases, franchise proposals, unlike open access proposals, are almost entirely generative.

5.7 The existence of competing services can also result in sub-optimal timetables caused by duplicated stopping patterns. Currently the independently planned timetables on the ECML result in duplicated calling patterns at some locations e.g. Grantham, Retford and Doncaster at the expense of journey time improvements to locations such as Newcastle, Edinburgh and Leeds where there is significant off-rail competition.

5.8 It would appear to East Coast that if open access operators are permitted to abstract over 70% of their revenue from an existing operator, then total industry cost can be reduced by removing open access.

6. Franchised Operator Costs

6.1 Whilst we agree that the rail industry should review consistently the need to reduce costs we consider that introducing more on-rail competition will actually increase costs.

6.2 The East Coast franchise has been competed for in 2005 and 2007. Competitors included substantial owning groups with histories of cost reduction in a competitive environment. These competitions required bidders to deliver a specified timetable which minimised costs and maximised revenue. In 2006 the franchise was converted into a management contract prior to re-let in 2007. In 2009 the franchise was again terminated and since then has been operated by a state owned company.

6.3 In the period December 2006 – December 2007 the GNER management contract strongly incentivised the owner to cut "controllable costs" in order to maximise value at re-franchising. In 2009, following the decision by the then owner only to support the franchisee to the extent contractually required, the owner was then again incentivised to cut costs in order to maximise the remaining length of the franchise and minimise the risk of cross default.

6.4 We consider that ORR has underestimated the extent to which the franchising process through competing for the market has driven out costs. At the start of the GNER franchise in 1996 the franchisee's contribution to UK Rail (fixed charge less subsidy) was [XX]. In 2011 through payment of the fixed charge and premia this has risen to [XX]. The total economic benefit is higher as after these payments the franchise is profitable.

6.5 East Coast Main Line Company Ltd is remitted to seek to maximise value at re-franchising. We therefore suggest that the combination of two competitive franchise bids, the circumstances of GNER and National Express towards the end of their respective franchises, together with the current remit to maximise value at re franchising has resulted in the franchise being operated at an efficient level of costs to the extent that those costs are controllable by the franchisee.

6.6 The largest single element of East Coast's cost base is Network Rail where currently there is no competition. It is with Network Rail where the potential for cost reduction is greatest. In the absence of competition we consider it to be ORR's role as the independent economic regulator to ensure that Network Rail operates at an efficient cost and is also receptive to its customers as though it operated in a competitive environment. We doubt whether an increased number of Train Operators would be more able to bring pressure to bear on Network Rail, as suggested in the consultation document, than an effective Regulator.

6.7 We do not consider that a franchised operator can achieve a 30% reduction in unit costs (Para 1.6). In East Coast this would require a reduction in cost greater than 100% of the paybill. In addition we note that the MVA analysis indicates that the current open access operators have higher unit costs than franchised operators. (MVA report Para 2.6.9)

6.8 We consider it to be overly simplistic to assume that a model which is responsible for less than 1% of timetabled km, whilst having higher unit costs, can achieve efficiencies through "density of operation" which will then enable them to operate at a lower cost than franchised operators, and this model can then be extrapolated across the remaining 99% of the industry.

6.9 We suggest to ORR that the subsidy open access operators receive through the allocation of interavailable revenue guarantees open access operators a disproportionate amount of their revenue, thereby facilitating a less efficient operation.

6.10 Whilst it is good news for freight customers that competition has led to reduced prices, we do not consider that this can be transferred to East Coast. We note that growth in rail freight of 60% has been achieved using half the locomotives. East Coast has undertaken an assessment of the level of service it could operate with only half of its train sets and the maximum service offer would be the existing half hourly frequency to Leeds plus an hourly service to Newcastle only. East Coast could not offer the existing half hourly service to Newcastle or any service to Scotland. With the exception of trains on planned maintenance, all of East Coast's fleet is in operation each day in the peak and on Sundays.

6.11 We note that in the freight example the efficiency gains have been taken as increased consumer surplus by the customer. This does not therefore assist in achieving the value for money challenge.

6.12 In comparison to freight, we note from the NRT yearbook that between 2002/03 and 2010/11 (the data range in the tables) freight tonne km grew by 3.8% whereas passenger km grew by 36.2%. The growth in passenger numbers since privatisation has been a resounding success for the passenger rail industry, and delivered almost totally by franchised passenger services.

6.13 We therefore dispute that the comparison of growth between open access and franchised operators as stated in paragraphs 3.10, 3.11 as being a true indicator. Any new start up business is likely to have higher growth than the pre-existing business, especially when it is able to offer cheaper fares through the subsidy available from ORCATS.

6.14 Had the rest of the industry achieved the same levels of growth as Hull Trains then passenger growth since 2002/03 would have been 120.6% or 11.9% compound. This is totally unrealistic and in any event undeliverable on the current network.

6.15 We wish to draw ORR's attention to the previous consultation document and our response. "Although the consultation document (ORR Review of Access Policy January 2010) (Para 2.12) states, "There is evidence that flows served by Hull Trains and Grand Central have experienced greater passenger growth than comparable control flows…" the Ove Arup report (Para 3.3.1) states, "The performance of the control flows is mixed with Newark achieving similar growth to Hull whilst the market from Wakefield has increased at a similar rate compared with Doncaster…" This evidence is contrary to the conclusion in the consultation document." We consider this evidence to be particularly important as Newark is the one location on ECML not to have on rail competition yet it has achieved similar growth to the location that has the strongest open access competition.

7. The MVA Case Study

7.1 In assisting ORR to reach an informed decision on the impact of increased on rail competition through open access we consider it regrettable that East Coast was not consulted by MVA. We find this especially surprising considering the current ownership of East Coast.

7.2 The East Coast franchise currently contributes [XX] to the DfT/UK Rail. In order to prevent an increased call on taxpayer funds this level of contribution will need to be maintained in the absence of any clear analysis as to how costs can be reduced by the MVA proposals. Examples of weaknesses in the MVA report include:

7.3 The quoting of an EU study into liberalised access, yet ignoring the evidence that Switzerland where the national operator controls the timetable enjoys the highest passenger km per capita in Europe (Summary);

7.4 "The operational practicality of the service specification is not explicitly considered" (Para 6.4.1). It is East Coast's view that options 3 and 4 would lead to increased costs and loss of capacity in the peak and at weekends;

7.5 It does not appear to take into account TUPE implications from transfer of work or the alternative redundancy/risk of industrial action and potential increase in drivers salaries due to increased competition (Para 2.6.11);

7.6 Section 5.7.1 says that it is assumed that the OAO services operate with 33% more seats than the equivalent Mark 4 coaches (as used by the franchise operator) but experience with Grand Central has shown that this is not the case as a lower density approach is used in standard class. There is little indication as to how this is fed in to the relative impact of service quality which is said to be "based on judgement" (section 4.5.9).

7.7 When analysing the WCML option 1, which gives two paths per hour to open access, section 6.3.8 states that the "OAO itself is not operating at the kind of scale where sufficient economies of density can be achieved". In contrast when looking at the ECML option 2 which is also 2 paths per hour for open access, section 6.4.13, open access does benefit from economies of density. The services offered on the ECML versus WCML are one service per hour to Leeds versus one per hour to Manchester, one service every two hours to Edinburgh versus Glasgow and one service every two hours to Newcastle versus Chester. It seems contradictory that a broadly similar level of service on the ECML generates economies of density, whereas it does not appear to do so on the WCML.

7.8 Unproven rolling stock assumptions (Para. 5.7.1, 6.4.17) in terms of impact on ambience, first class loadings, yield management, weekday and weekend peak loadings and future growth (though the latter is acknowledged);

7.9 An increase in costs caused by the fragmentation of the rolling stock fleet and depots;

7.10 Cost implications of changes in Station and Depot Facility Owners;

7.11 As the consultants did not engage with us as the current operator we have been unable from the information provided to assess the financial impact of Options 1 and 2.

8. Testing the Benefits of Competition

8.1 We suggest that an impartial analysis of the impact of on rail competition should have examined the impact of competition on ECML, including the impact on total industry costs, opportunity cost and alternative uses of scarce track and rolling stock resources. Such a comparison would include the benefits of a timetable constructed to maximise passenger benefits rather than disparate shareholder value, increased revenue from service enhancements being delivered earlier, (e.g. Leeds half hourly), and lower costs through the operation of services to locations such as Sunderland, Bradford and Harrogate as extensions of existing services rather than by the operation of duplicated services on the core route.

8.2 In terms of efficient use of scarce resource, the existing Grand Central rolling stock utilised in delivering a holistically planned East Coast timetable, focussed on maximising passenger benefits, could deliver the existing frequency to Sunderland and Bradford and in addition deliver 4 trains a day between London and Harrogate and also a half hourly frequency between London and Edinburgh. In addition to the current benefits that competition has brought to Bradford and Sunderland, which would be retained, a single operator with the Grand Central resources could deliver a reduced journey time to Bradford by 35 minutes, new direct services between London and Harrogate, increased frequency between London and Edinburgh where air competition is highest on ECML, and greater connectivity between Peterborough, Newark, Doncaster, Northallerton, Durham and Alnmouth with Scotland. As these benefits are delivered through a more efficient timetable, the additional costs of providing the additional benefits would be zero or close to zero. As Grand Central has higher unit costs, the additional benefits may be delivered for a lower total cost.

8.3 Such a proposal would reduce track occupation south of Doncaster, the most congested section of the ECML and may avoid capital expenditure.

9. Conclusion

9.1 East Coast competes vigorously with road, air and other substitutes to travel. This off-rail competition has driven consumer benefits for rail customers.

9.2 The experience of on-rail competition on East Coast Main Line is that it has delayed the delivery of greater passenger benefits, and it is supported by a transfer of revenue from the taxpayer to the open access operator. We agree with MVA in that “on-rail competition is not necessarily a driver of reductions in industry cost” (Conclusions Page iv). Due to the high level of abstraction permitted it has increased total industry cost.

9.3 It is disappointing that MVA did not engage with East Coast as the current franchised operator.

9.4 For the reasons outlined in this document we do not consider the case for increasing on-rail competition to be proven from a customer benefit or cost perspective. A holistically planned timetable delivering the Government's specification would deliver greater benefits at lower cost.

Appendix 1 East Coast Response to ORR Review of Access Policy April 2010

The following is East Coast Main Line Company Ltd's. response. We are content for it to be published.

Impact Assessment

We support the increase in transparency of the not primarily abstractive test. Following recent experience on the ECML we suggest the industry needs to consider how it can accurately assess available capacity and also the impact on performance due to the operation of additional trains, to enable Network Rail to make informed decisions between passenger and freight traffic on the Network.

On - Rail Competition

The majority of on - rail passenger competition has taken place on ECML and it is from that experience that the following comments are made.

We agree that the potential for effective competition is well known. In the case of the ECML the dominant competition is air and road. In assessing the effectiveness of on - rail competition many of the benefits of competition, (e.g. choice, incentives to innovate, such as improved internet booking and wifi on trains) have already been delivered in response to the threat from non - rail competition, competitive franchise procurement and the incentives built into the franchise financial model. We suggest that ORR also considers the impact on - rail competition may have on the rail industry's ability to compete with other modes and also the impact on industry funding.

We disagree that the evidence of the benefits from open access services is strong.

The consultation document does not take into account the opportunity cost of open access. The recent open access applications on ECML resulted in a 17 month delay for the then franchised operator delivering a half hourly service to Leeds. It has also delayed the implementation of the SLC 2 timetable. Both these events led to delay in improving the rail competitive position versus air and road in highly competed markets. The actual result is that to date there has been a net loss in seat provision on ECML compared to the franchise plan being delivered on time.

The other aspect of opportunity cost we suggest ORR considers is where as a result of competing access applications the resultant timetable is sub optimal. Although some markets gain, the overall competitiveness of rail compared to non rail across a whole route may suffer. There is also evidence that the competitive nature of competing access applications, unnecessarily consumes capacity.

Although the consultation document (Para 2.12) states, “There is evidence that flows served by Hull Trains and Grand Central have experienced greater passenger growth than comparable control flows…” the Ove Arup report (Para 3.3.1) states, “The performance of the control flows is mixed with Newark achieving similar growth to Hull whilst the market from Wakefield has increased at a similar rate compared with Doncaster…” This evidence is contrary to the conclusion in the consultation document.

The statement, “It has brought about passenger benefits (by) providing new direct services to London from areas poorly served, with a population of more than 2 million” (Para 2.12) is incorrect. The Ove Arup report has used the population within a 10km isochrone of stations which had previously had no or a poor direct service to London. However this ignores that the 10km isochrone of:

- Sunderland overlaps with that of Newcastle;
- Sunderland overlaps with Durham;
- Eaglescliffe overlaps with Darlington;
- Thirsk overlaps with Northallerton;
- Selby overlaps with York;

and therefore some of the populations within these 10km isochrones are closer to other stations which are already well served.

In addition, the 10 km isochrone of Sunderland also includes 6 Metro stations with a high frequency service to Newcastle and the 10km isochrone of Brough and Hull does not take into account the natural barrier of the river Humber and the accessibility of Doncaster from South Humberside via the M18.

Local population levels are not an accurate indicator of demand for inter city services. A simple comparison of Bradford and Harrogate or Leeds and York would confirm this.

We agree that open access operators have increased passenger numbers but to a smaller proportion than the franchised operator. At privatisation, the franchised operator ran 100 trains on weekdays. This has now grown to 136 trains per day, all of which are formed of trains with a capacity of around 540 seats. In contrast since privatisation open access operators have provided 28 trains per day (including the new GC services to Bradford) but formed by trains with around half the capacity of the franchised services. From May 2011 the franchised operator will provide a further 24 trains a day with a mixture of 540 and 270 seat capacity.

By May 2011, since privatisation, the franchised operator will have provided an additional 28600 seats per weekday compared with an additional 7500 by open access operators.

We also suggest that the increase in train services by the franchised operator has resulted in greater passenger benefits not only through the provision of more seats but due to the franchised business case for increasing train services being dependant upon a business model which is approaching 100% generative. The business case for the Leeds half hourly increase and SLC 2 timetable change are both predicated upon growth and modal shift due to generalised journey time improvements specifically at Wakefield and Leeds and also York, Darlington, Newcastle and Edinburgh. However the business model for open access appears to require less than 50% of new traffic to be generated as, “because such a level of generation is so unlikely that few, if any, services would be approved”. (Para 2.31)

In summary we consider the benefits from on - rail competition to be less than that claimed by the Ove Arup report and the consultation document. We suggest that whilst the “not primarily abstractive test” is adequate for routes which are not capacity constrained, on routes which are capacity constrained, it should be replaced by a “primarily beneficial test”. This would include the current testing for abstraction but also take into account the opportunity cost of the proposal.

Capacity Choices

We do not support the concept of “freight versus passenger”. Although there is a history of conflict in this area on ECML in our view this has been due to the lack of accurate information on available capacity. It is actually a staggering achievement that by May 2011, the infrastructure on the ECML will have delivered an additional 88% weekday intercity services to/from London in addition to the growth that has taken place on the First Capital Connect, Cross Country and TPE franchises. Virtually all of this has been delivered through timetabling solutions. In order for the industry to make informed choices on capacity there needs to be a more innovative approach to timetabling solutions, accurate capacity analysis and changes to access charges to enable growth in passenger and freight.

If any further information is required on the points raised in this response please contact Adrian Caltieri on 0845 059 3057 adrian.caltieri@eastcoast.co.uk

Appendix 2 East Coast Main Line Existing On-Rail competition.

Station	**Competitor**
Stevenage	FCC, Hull Trains
Peterborough	FCC
Grantham	Hull Trains
Newark	EMT (Newark Castle)
Retford	Hull Trains
Doncaster	Hull Trains, Grand Central, EMT
Wakefield	Grand Central, EMT
Leeds	EMT
York	Grand Central, Cross Country, TPE
Northallerton	Grand Central
Darlington	Cross Country, TPE
Durham	Cross Country, TPE
Newcastle	Cross Country, TPE
Alnmouth, Berwick, Dunbar	Cross Country
Edinburgh (Central Belt)	Virgin West Coast, Scotrail