



OFFICE *of the*
RAIL REGULATOR

**NEW SERVICE OPPORTUNITIES
FOR PASSENGERS**

**A CONSULTATION DOCUMENT ON THE
DEVELOPMENT OF THE COMPETITIVE
FRAMEWORK FOR
PASSENGER RAIL SERVICES**

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New service opportunities

Regulator's foreword

This consultation document is about the possibility of relaxing the restrictions on train operators - both those new to the network and franchisees outside their franchised areas - to enable them to offer new services to passengers. The current regulatory system confers a large measure of territorial exclusivity in favour of each of the 25 franchised train operators. The issue is simple but very important, for passengers in particular: whether that degree of protection from competition should be reduced in the period from 1999 to 2002; or whether it should be retained. But the overriding consideration is which system is going to produce better railway services for passengers generally?

All of the 13 companies who now operate the 25 franchises competed to buy those franchises against clear and predictable rules on competition set by me¹. They were: extensive protection from additional competition in the period from grant of franchise until, at the earliest April 1999; for a further three years, limited exposure to additional competition, with up to 20 per cent of their revenues at risk from new competitive services; and from 2002, new policies as to the degree of protection, if any, from open access competition. Is there now a case for changing this framework or should the current provisions remain in place?

One franchisee's protection is, of course, another's obstacle to expansion. At present, if a franchisee decides to offer only the minimum required by the Franchising Director and reduces the level of service to passengers, no one can come in and try to do a better job than the franchisee.

Even under the current rules we are seeing signs of a readiness to expand services, examining new market opportunities where the dominant supplier is not active. One purpose of the consultation document, therefore, is to get an indication of how quickly and how extensively new services might be introduced to the benefit of passengers. But the consultation has a wider purpose; and it requires some analysis of why the system adopted in this country evolved in the way it did.

There are four main principles which form the base of the current framework for the promotion of rail for the benefit of passengers. The first is the *duty* on the Government (exercised through an agency-type relationship with the Franchising Director) to specify those minimum services which the Government requires to be operated - the Passenger

¹ *Competition for railway passenger services: a policy statement*, December 1994

Service Requirement or PSR - and to acquire those services for the best value for money. The second is the *duty* on Railtrack, as the sole owner of the infrastructure, to provide access to that infrastructure, to all passenger train operators, without discrimination, and on public interest criteria established by the Regulator. The third is the *duty* on all licensed train operators to be parties to a set of multilateral arrangements to ensure network benefits for passengers. The fourth is the *right* of passenger train operators to decide whether to engage in commercial activities which in their best judgement meet passenger demand and thus advance their business prospects during the period of their franchises.

Almost four years after the enactment of the Railways Act 1993, and six months after the transfer of the last passenger railway business into the private sector, it is timely to look again at each of those four principles and test whether it remains appropriate to stay with the regulatory contract first established in 1994 and allow a greater freedom to challenge the territorial monopoly of existing franchisees.

In December 1994, when I issued my policy statement on competition for railway passenger services, all passenger train services were under the control of British Rail. There was no experience of competition, and there was a real concern that the Government would not attract buyers, or that buyers would exact exceptionally high prices, if the buyers were given no protection from competition. Competition, it was said, would make it impossible or too expensive to sell the franchises. It was also said that competition, at the expense of subsidy, was inefficient. Would it not be better if the idea of competition *in* the market, as distinct from competition *for* the market, was dropped?

I therefore established tight controls over new competitive entry until 1999, effectively constraining competition to those routes where two or more franchisees already provide services. But I concluded that it was in the interests of both passengers and operators that there should be the firm prospect of competition before the expiry of the initial access agreements, and proposed a limited relaxation of controls on competition to take effect in 1999. There will be a further full review of policy in 2002, although I said in my earlier policy statement that I expected changes in the competition framework after that date to be incremental.

These arrangements were included in Schedule 10² of the passenger track access agreements for franchised operators³, and mean that the second stage of moderation of competition

² Schedule 11 in the case of LTS, South Central and South West Trains.

³ Except for Gatwick Express where specific arrangements were developed, and Island Line which was sold as a vertically integrated franchise, operating the network as well as trains

(MoC) can commence at any time from 1 April 1999. However, the timing of Stage II is dependent on the issue by the Regulator of an 'Initiation Notice', which also needs to include specific provisions on a number of elements affecting the implementation of Stage II. In order to ensure that decisions on the implementation of Stage II are taken in a manner that is consistent with wider policy issues, the timing and content of the Initiation Notice need to be decided, at the very latest, in early 1998. The purpose of this document is therefore to seek views on whether implementing the conclusions I arrived at in 1994 will produce benefits to passengers and, if so, how can they be delivered in a practical way. Passengers, operators and taxpayers supporting the industry through subsidy need to be reassured that the extension of competition envisaged in my original policy is likely to provide real opportunities for new and improved services for passengers and that any detrimental effects can be effectively controlled.

I have emphasised, in my recent statement of objectives for passenger train operators⁴, the importance of promoting both cooperation and competition to achieve the objective of promoting the use of the network for the greatest benefit to passengers. All train operators, at least for some part of their revenues, compete for the goodwill of passengers with other train operators. And the same train operators must cooperate to provide the network benefits which passengers rightly expect, in terms of published timetables with good connections and spread of services, accurate and impartial information on services and retailing of tickets, and the ability to purchase through tickets where a journey involves the services of more than one operator. There are further elements of regulation, for instance the Franchising Director's requirements for interavailability of tickets, except where that benefit is outweighed by the benefits of competition. These arrangements must be continued, even though the existence of multilateral agreements, for example on the allocation of ticket revenue, also affects the commercial incentives on competing companies.

But setting competition to work is also relevant. Freeing up the market would provide additional opportunities for operators to develop their services. My aim is to encourage private sector operators to identify and pursue new business opportunities, with the Regulator ensuring that these new developments are not contrary to the public interest. So while I would not approve new access rights which would clearly operate against the interests of passengers generally, it is not for me to back my commercial judgment against the commercial judgement of operators proposing new competitive services. My role is therefore to ensure that where competition develops it is in such a way that passengers and taxpayers can expect to gain overall, and that the cooperation needed to maintain network benefits is maintained. I

⁴ *Regulatory Objectives for Passenger Train and Station Operators*, June 1997

believe that I have the powers to achieve that, and describe them in this consultation document.

Competition is a potential source of pressure for reducing costs and introducing innovative new products which benefit consumers while offering producers the opportunity to earn profits. But from 1999 2002, as in the period 1995 1999, *unrestrained* competition in the railway sector would not produce the right result for passengers or produce it at a cost which the State is willing to pay for. I would therefore want to have confidence that a limited relaxation of current restrictions could be expected to generate worthwhile new journey opportunities and increased value for money for passengers and would not detract from the existing areas of cooperation which passengers value and depend upon to deliver essential network benefits.

I am therefore seeking views on matters of principle as well as practicability, asking consultees for their best judgment on the *effect* of relaxing the restrictions on competition as envisaged in the current rules; on whether I should go back on that 1994 Statement; and, if I go ahead, on what further protection or assurances need to be offered to make competition service the interests of passengers. Thus I want to understand how far passengers have welcomed the outcomes of the limited competition which has occurred so far, whether they would welcome an early extension of the opportunities for competition in a way that leads to new service opportunities and what adverse consequences might arise from such an extension.

I also want to understand the perspective of Railtrack and the private sector franchisees, given that the current policy was established when all the operators were in the public sector, and of passengers and their representative organisations, now that all of them have had the chance to experience a multi-operator railway. It is then my intention to examine in depth any issues raised during this consultation, before publishing a policy statement next year. I will publish the results of this consultation process, and my programme for analysing the issues raised, after the consultation ends.

I look forward to constructive responses to this consultation.

JOHN SWIFT QC
Rail Regulator

September 1997

Summary of Issues

The key questions for the Regulator, which are discussed in more detail in this consultation document, are:

- what are the features of the railway industry that need to be taken into account to decide whether relaxation of constraints on competition will achieve overall benefits to passengers and taxpayers, and will promote the use of the rail network?
- what are the main opportunities for new services and other passenger benefits that might follow from an extension of competition along the lines envisaged in Stage II?
- to what extent should private sector operators take the initiative in identifying opportunities for new entry (as envisaged in the current Stage II policy)?
- what are the main potential detriments in terms of disadvantages to passenger and effects on existing franchises? what further controls, if any, need to be built into the regulatory framework to prevent such detriments?

The document is in three main parts. Part A outlines the current competitive environment, and considers the implications of allowing further developments in competition. Part B discusses the criteria and mechanisms which the Regulator might rely on to prevent new competitive access rights being used in a manner that is not in the interests of passengers. Finally, the Technical Appendix, which is in a separate volume, considers the issues that will need to be decided in implementing Stage II. All three parts raise specific questions on which you may wish to make representations.

Next steps

The timetable for considering the implementation of Stage II currently envisages a three stage process:

- Phase 1 - this consultation period, followed by publication of the issues raised by consultees, the Regulator's initial response to those representations and a programme of further analysis;
- Phase 2 - a programme of analysis and research designed to explore and quantify the significance of the issues raised by the consultation process; and
- Phase 3 - publication of a policy statement setting out final decisions regarding implementation of Stage II and, if required, the issue of Stage II Initiation Notices.

In the event that the Regulator decides to initiate Stage II, he will also issue a document which:

- sets out the detailed framework within which Stage II of MoC will operate;
- sets out the procedures which train operators will be required to adopt in making nominations for protections under the Stage II arrangements; and
- sets out the criteria against which such nominations will be evaluated.

Full implementation, including processing of relevant nominations and the incorporation of new train services into the national timetable would then follow, with the earliest date for the commencement of new timetabled competitive services being September 1999.

Responses

The Regulator seeks written responses to the questions raised in this document. He also welcomes informal discussion with passenger train operators and others with an interest in any issues raised. Furthermore, the Regulator intends to explore a number of these issues at the seminar proposed for October 1997.

Written responses should be sent by 21 November 1997, to:

Phil Smith
Manager, Competition Policy
Office of the Rail Regulator
1 Waterhouse Square
138-142 Holborn
London
EC1N 2ST

Unless they are marked as confidential, they will be placed in the ORR library at the end of the consultation period, and will be made available on request to interested parties.

Additional copies of this document and the Technical Appendix are available, free of charge, on request from the Office of the Rail Regulator.

Telephone: 0171 282 2001;
Fax: 0171 282 2045;
Email: orr@dial.pipex.com; or
write to the Librarian at the address shown above.

Part A: The Competitive Framework

Current policy framework

- 1.1 The Regulator has, among his statutory duties, the duty to promote competition in the supply of railway services. Competition is not of course an end in itself. But it is an important source of potential benefit to passengers, through pressure to innovate and to reduce costs. Railways face competition from other modes of transport, both public and private. In addition, privatisation of the passenger rail industry has increased the sources of competition faced by train operators by introducing competition *for* the market (through the franchising process) and on-rail competition between operators *in* the market.
- 1.2 In the light of the Regulator's policy on moderation of competition (MoC), the scope for on-rail competition is, until 1999, effectively limited to competition between franchisees where their services overlap. In general, no new competitive entry is permitted on any point-to-point flow where an operator provides a direct service and which represents more than 0.2% of an operator's farebox revenue⁵, with additional protections (for example through the specification of alternative termini which could be used to establish competing services) to provide the assurance about future revenue which was judged necessary for franchising to be successful.

The franchise map

- 1.3 The specification of franchises was the responsibility of the Franchising Director. He has awarded 25 separate franchises. These represent a disaggregation of British Rail's former activities both by sector (InterCity, Network South East and Regional Railways) and geographical region. A consequence is that many routes are already served by more than one operator. Often this is simply an operator of high speed inter-urban trains and an operator of local services⁶, although some markets are also served by operators using parallel routes. There are, for example, four different operators serving the London - Birmingham market, although these services depart from three different London termini.

⁵ Lower thresholds apply for a small number of operators

⁶ For example, Great Western Trains provide high speed services between London and Reading, with Thames Trains providing alternative, generally slower, services

- 1.4 The MoC notices issued by the Regulator for franchised passenger operators generally allow all existing operators on a route to seek additional access rights, but would not allow a third party to bid for such rights. In addition, the MoC notices allow for a small number of new competitive services, the majority of which had been planned when operators were still under public ownership. The main example of such a service is the new Gatwick to Rugby service introduced this year by Connex South Central. The MoC notice for North London Railways specifically made provision for the new Connex service, whilst the Connex South Central notice also made provision for North London Railways to operate services between Watford Junction and Gatwick.

New services during Stage I

- 1.5 The franchising process itself has generated commitments for a number of new services, as well as a continuing reduction in the level of subsidy required by operators. The level of interest in franchise bids, and the number of successful bidders provides considerable scope for effective competition both for and in the market. The Regulator has thus made it clear that he would expect any further mergers within the industry to demonstrate substantial public interest benefits before he would support them. The current structure has considerable potential for demonstrating innovation in new types of service.
- 1.6 The decisions taken by the Regulator in implementing Stage I of MoC mean that new competitive entry is prohibited on approximately 4200 point-to-point flows. Within the constraints of Stage I a number of new services may still be possible. These could arise in one of two ways. The first way would be to revise existing service patterns, without seeking new access rights. South Wales and West Railway, for example, has introduced new through services on flows which would otherwise be protected from new entry by combining existing access rights. The Regulator has confirmed, following an appeal, that such a combination of rights is permitted under the existing access agreement.
- 1.7 The second means of introducing new services is to identify combinations of point-to-point flows which are not protected under Stage I. There is little evidence to date to suggest that operators have found this to be a commercially viable proposition, although a number of potential services are being examined, such as the Rochdale to London service proposed by North Western Trains. There is some evidence to suggest that the protection of certain flows is restricting the development of new direct long distance services. This is because the commercial viability of such services requires

that the train calls at a combination of stations that are prevented under the Stage I arrangements. For example, a direct service between Glasgow and Ashford that calls at Edinburgh would be prohibited because the Glasgow - Edinburgh flow is protected.

Competition and cooperation: promoting the public interest

The benefits of the franchised railway

- 1.8 The franchising process has its justification in its ability to deliver a range of benefits to passengers including commitments to new direct services, higher service frequencies, new or refurbished rolling stock, station improvements, and commitments to increase integration with connecting bus services. In addition, fares control has been imposed as part of the franchising process on a range of fares, particularly in the commuter market. The Franchising Director also requires that for almost all journeys an inter-available ticket is available which is valid on the services of all operators. The continued existence of the Travelcard within the London area, and similar products in PTE areas, has not been affected by the franchising process.
- 1.9 Rail services are, of course, in competition with other modes. For many passengers, the main alternative to rail is the car. But rail also competes with other public transport: for example, it competes on inter-urban routes with long distance coach services, particularly for leisure passengers. The Monopolies and Mergers Commission, in its report on the award of the Midland Main Line franchise to National Express Group, accepted that competition between rail and coach could be expected to act to the benefit of passengers, and that its loss would therefore be against the public interest.
- 1.10 On-rail competition is in a different category. It is 'head to head', one rail company striving to compete in the same mode of transport, bringing benefits to passengers through greater incentives to reduce prices or improve services whether or not inter-modal competition is already present. On-rail competition between passenger operators is still a relatively new feature of the railway industry. The potential benefits to passengers of on-rail competition are largely unquantified, although there is some evidence to suggest that operators are keen to enter new markets beyond the boundaries of their franchises.
- 1.11 At the same time, it is clearly important that rail passengers should be able to enjoy the benefits of a national rail network in terms of such features as a single national timetable with a spread of services and connections, the ability to book through tickets, including inter-available tickets which are valid for travel on different

operator's services, and to obtain accurate and impartial advice on services and fares. Obligations on all passenger operators to cooperate to provide a range of national arrangements are included in their licences, and enforced by the Regulator. The Regulator has made it clear that, if these national schemes do not reach appropriate standards of performance, he will take action.

Potential benefits of increasing competition

- 1.12 The Regulator considers that competition and cooperation can be made to be complementary in promoting the interests of passengers. Indeed, cooperation to the exclusion of competition could lead to collusion between operators which is against the public interest, for example by stifling the development of new or improved services for passengers. That is why the Regulator, in his objectives for passenger operators, stressed the importance of achieving an appropriate balance between cooperation and competition which promotes innovation and improvements in the interest of passengers, operators and taxpayers.
- 1.13 During Stage I it has become apparent that some new services that would have generated significant benefits for passengers have been prevented. Whilst Stage I made provision for operators to waive their protection rights, experience to date suggests that such agreement is generally not given. Moreover, the controlled expansion of on-rail competition has the potential to act as a catalyst for significant passenger benefits. These benefits include lower fares, higher service frequencies on well patronised flows, better quality standards and more direct services. Stage II, as originally envisaged, would facilitate the introduction of such new services.
- 1.14 Of course, there is no guarantee that all new services will provide these benefits. The Regulator therefore wishes to explore the extent to which new competitive entry can be controlled by means of the access and licence regimes, also having regard to the current obligations of franchisees in respect of inter-available fares, so as to minimise the threats posed by destructive competition and the potential detriments identified below. Part B of this document presents options for managing new competition so that it does not result in detriments for passengers and seeks views on their likely effectiveness.

Potential detriments to be avoided or controlled

- 1.15 The Regulator is aware that, even in cases where capacity is constrained, a relaxation of the restrictions on competition could lead to 'rail wars' as observed in the unregulated bus industry. In such intense competitive activity to obtain and retain

market share, the following potential detriments to competitors or passengers or both have been identified:

- (a) predatory service timetabling, or the bunching of services at certain times;
- (b) predatory pricing designed to offer tickets at an uneconomic price with the intention of forcing a competitor out of the market;
- (c) discriminatory behaviour such as restricting the access of passengers or operators to station facilities;
- (d) biased retailing and discriminatory provision of train service information;
- (e) increasing the cost and complexity of ticket retailing;
- (f) a loss of general inter-availability of tickets and a reduction in rail's flexibility as a 'turn up and go' service;
- (g) more widespread introduction of dedicated advance purchase fares which provide the benefits of lower prices but detract from rail's flexibility as a walk-on service;
- (h) general uncertainty as to the predictability of service frequencies;
- (i) an increase in subsidy requirements in the longer term and an overall decline in the number of subsidised services; and
- (j) the reallocation of resources away from optional services on heavily subsidised routes to more commercially attractive ones.

The Regulator considers that, if operators and passengers in the railway industry are to enjoy the benefits of competition whilst deterring operators from engaging in anti-competitive practices which reduce rail's overall ability to compete with other modes, the right control mechanisms must be in place.

Consultation questions on Part A

1.16 The Regulator would welcome views on these issues, and in particular on the following questions:

Q1 Are there any new factors, not taken into account in 1994, which would argue against initiation of Stage II?

- Q2** What types of services can be expected to emerge in Stage II and what are the most likely benefits and possible detriments for passengers?
- Q3** Is there any reason to believe that the incremental approach to the development of competition depicted in the Stage II mechanisms is an inappropriate way of extending competition to the railway sector?

Part B: Regulatory Controls on New Services

The role of the Regulator in approving new access rights

- 1.17 The moderation of competition policy, for both Stages I and II, is a mechanism by which Railtrack is precluded from selling access rights on specific point to point flows. The policy, when implemented, provides Railtrack and train operators with details of those flows that are protected from competitive new entry. Implementation also identifies those flows upon which Railtrack is not precluded from selling access rights.
- 1.18 This part of the document presents the issues that the Regulator will examine when he considers the effects of proposals for new access rights, where the sale of those access rights is not precluded under the Stage II arrangements. It also considers the possible role of other mechanisms that are available for preventing the use of access rights in a manner detrimental to the interests of passengers and what the likely timescales might be for approving access rights that could emerge as a result of Stage II being implemented. It also considers briefly other powers which could prevent passenger detriments in the non-access area.

Approval of access rights in the Stage I period

- 1.19 During Stage I of MoC, which is designed to give real security to the new train operators, the Regulator has stated and implemented his policy "not to be sympathetic toward bids for access rights which are primarily abstractive"⁷. The Regulator has said that he will look to the operator seeking approval for new rights to explain the passenger benefits that are likely to result. These benefits to passengers might come through improved frequencies, lower fares or new journey opportunities resulting from the introduction of through services or provision of improved connections. Provided the operator seeking new access rights can demonstrate that there is a reasonable expectation of additional passenger benefits, and the Regulator considers that the impact on existing services is not sufficiently great that the overall outcome is likely to be to the detriment of rail passengers, the Regulator would normally expect to approve those rights, subject to them also satisfying other existing criteria. His

⁷ The implementation of this policy was outlined in a letter dated 21 February 1997 to Managing Directors of Train Operating Companies, a copy of which is at Annex A

objective is to minimise the opportunity for new services that are designed solely to capture an incumbent's revenues without providing material benefits to passengers.

- 1.20 The Regulator proposes to apply similar criteria when considering access proposals which take effect within the Stage II period. However, in addition, the Regulator wishes to consider if other mechanisms are available which could be relied upon to deter the use of access rights in a manner which damages the competitive process and the new structure.

The role of the regulatory framework in preventing passenger detriments

- 1.21 The Regulator believes that it is in the public interest for train operators to offer new services designed to deliver benefits for consumers and to grow the rail market. The Regulator is therefore keen to ensure that adequate mechanisms exist to prevent access rights being used in a manner which does not promote that objective. Thus the underlying principle would be to ensure that access rights are used in a way that serves the interests of passengers, and to rely on the access and licensing regimes to prevent any adverse consequences for passengers generally.
- 1.22 Within the access regime, Access Condition D contains the criteria used by Railtrack to decide the details of timetable planning, particularly in the event of a conflict of operators' interests. One criterion is that Railtrack should "ensure that, where the demand of passengers to travel between two points is evenly spread over a given period, the overall pattern of rail services should be similarly spread over that period". There is no hierarchy in the decision criteria, and it might not be possible for Railtrack to achieve an evenly spread timetable without conflicting with other criteria. But where there was no conflict, this criterion would require Railtrack to attempt to deliver a timetable that was as evenly spaced as possible, and would limit the scope for operators to develop predatory train service timings.
- 1.23 The Regulator would welcome views on whether the existing criterion is sufficient to achieve this objective or whether it might be sensible to add a new criterion designed to ensure that where services between two stations are provided by more than one operator, the timing of those services should not, in itself, give rise to one operator enjoying an inherent competitive advantage, unless such timings were the only possible solution and would facilitate significant passenger benefits⁸. Such a new

⁸ The Regulator will be consulting more generally on the criteria and procedures for approving new access rights, and on the timetabling process, in the Autumn. These issues will be considered further in those consultations

criterion could be proposed by the Regulator or an industry party under the arrangements for changing the Access Conditions.

- 1.24 The Passenger Train Operator's licence contains provisions that, in effect, require dominant operators not to act in a discriminatory or anti-competitive manner. The Regulator's powers to act in the event of a suspected breach are an effective deterrent where operators have a clear understanding of what kind of action might constitute such a breach. The proposed changes in general competition legislation that are designed to move towards a prohibition regime are likely to strengthen the Regulator's powers in such matters.
- 1.25 Licence compliance, and the station access regime could also be expected to act as a deterrent against operators wishing to engage in selective or partial retailing, discriminatory provision of train service information, or restricting access to station facilities. Commercial pressures are likely to militate against action which either unreasonably increases the cost of selling tickets or makes ticketing options even more complicated for passengers to understand. It is clearly important to strike a balance between inter-availability and the 'turn up and go' flexibility of the railways, and more widespread introduction of cheaper advance booking tickets.

Timescales for approving access rights for the Stage II period

- 1.26 The current implementation timetable for Stage II of MoC raises a number of issues relating to the approval of proposals for new access rights. The key dates of that plan are:

Publication of the results of this consultation	November 1997
Publication of a policy statement	March 1998
Issue of Stage II Initiation Notice	31 March 1998
Publication of criteria and procedures	March 1998
Final Stage II Nomination Date	30 June 1998
Issue Stage II MoC Notices	30 September 1998

NB. The last three steps will only follow if the Stage II Initiation Notice is issued.

- 1.27 There is already evidence to suggest that some train operators are actively seeking access rights designed to take advantage of the reduced levels of protection that would emerge under Stage II. This is, at least in part, because where those new services

require the procurement of rolling stock, the lead times can be as much as two years. In such circumstances operators are understandably reticent to enter into leasing agreements without some certainty regarding the availability and cost of the associated track access.

- 1.28 The constraints of the Stage II mechanism are such that there will be two key dates that will confirm the level of protection that will be enjoyed by incumbent train operators. The first key date is that on which the Regulator issues the Stage II Initiation Notice for each of the operators. If Stage II is initiated, this date is currently expected to be 31 March 1998. These notices would confirm each operator's materiality threshold⁹. The confirmation of those thresholds is likely to enable both Railtrack and potential train operators to identify a number of flows where they believe that new entry will be unrestricted, subject to the application of the special nomination process, during the Stage II period.
- 1.29 The second key date is the Stage II Nomination Date, which is the last day by which operators would need to submit their nominations and which would affect the subsequent issue of the MoC Notices for the Stage II period. These notices, the last of which could be expected to be issued by 30 September 1998, will provide the complete picture of the opportunities for new competitive services, in time to enable operators wishing to take account of those opportunities to seek new access rights and prepare their bids for the Winter 1999 timetable.
- 1.30 Individual proposals for new access rights for the Stage II period would fall into various categories:
- (a) access rights consisting only of flows that are not protected from competitive new entry under the Stage I arrangements could be approved now;
 - (b) access rights consisting only of flows that will qualify as 'pre-existing contested' flows could be approved after a Stage II Initiation Notice has been issued; and
 - (c) access rights consisting of flows where competition was to be relaxed under the Stage II arrangements (i.e. flows nominated as contestable by an incumbent operator, but not qualifying as a pre-existing contested flow) could

⁹ The materiality threshold determines which flows are regarded as part of an operator's core business. Flows below the threshold, in both Stage I and Stage II, are not protected from competitive entry. These terms are defined and explained in the Technical Appendix, published as a separate volume

only be approved after the relevant Stage II MoC notices have been issued (30 Sept 1998).

In theory, category (c) access rights could be approved after the issue of the Stage II Initiation Notice, but any such approval would need to be conditional upon those rights not subsequently being found to be in breach of the Stage II arrangements. The Regulator considers that such an approach would be difficult to implement and could lead to numerous speculative bids for new rights and considerable amounts of abortive work¹⁰.

Consultation questions on Part B

1.31 The Regulator would welcome views on these issues, and in particular on the following questions:

Q4 Are there additional measures which the Regulator should consider in order to protect passenger interests, including network benefits, during Stage II?

Q5 Are licence compliance powers sufficient to prevent a reduction in network benefits, and can commercial pressures be relied upon to maintain the right balance between dedicated tickets and flexibility?

Q6 In particular, is it desirable to retain a link between the approval of access rights and the degree of farebox revenue abstraction?

Q7 Is it feasible to use Access Condition D and licence compliance as a means of deterring the use of access rights in an anti-competitive manner, and the emergence of anti-competitive practices? would amendment to Access Condition D make this more effective?

Q8 How can the system of nominations and approvals be managed so as to minimise uncertainty as to the timing and scope of introduction of new services?

¹⁰ Proposals for new competitive access rights could be approved by the Regulator at any time if the incumbent operator(s) has agreed to waive their protection

Annex A: Letter to TOCs dated 21 February 1997

Letter to Train Operating Companies of 21 February 1997

DEVELOPING NEW SERVICES TO PROMOTE THE USE OF THE NETWORK

One of the Regulator's statutory duties is to promote competition in the provision of railway services. He has said, in his policy statement on competition (Competition for railway passenger services, December 1994), that he remains convinced that there are substantial benefits to both train operators and passengers to be realised from an increase in competition. However, as you know, the Regulator decided that he should moderate competition in core markets to facilitate franchising. In some cases, this protection was subject to conditions allowing other named operators to seek to obtain new access rights as well as the incumbent operator. There are no contractual restrictions on Railtrack agreeing to provide access on other flows, although the Regulator indicated in his policy statement that he 'will not be sympathetic to bids for new access rights that are primarily abstractive'.

This letter sets out the criteria and procedures the Regulator proposes to adopt in evaluating competition issues where his approval is sought for new access rights which are not protected from competitive entry, or where protection is conditional.

Criteria

In line with the duties placed on him in section 4 of the Railways Act, the Regulator welcomes new competitive services which bring benefits to passengers. These benefits might come through improved frequencies, lower fares or new journey opportunities resulting from the introduction of through services or provision of improved connections. The Regulator will look to the operator seeking approval for new rights to explain the passenger benefits that are likely to result.

The Regulator recognises that the development of greater competition will involve a balance between the interests of the new entrant and of the incumbent operator. Where a new service might have a material adverse impact on existing services, the Regulator will, therefore, give the incumbent the opportunity to make representations to him. If an incumbent operator argues that the financial impact on its own services is sufficiently great to threaten their viability and risk their withdrawal, and that the overall impact will be to the detriment of

passengers, the Regulator will also seek the views of the Franchising Director (and PTE where relevant).

Provided the operator seeking new access rights can demonstrate that there is a reasonable expectation of additional passenger benefits, and the Regulator considers that the impact on existing services is not sufficiently great that the overall outcome is likely to be to the detriment of rail passengers, the Regulator would normally expect to approve those rights, subject to them also satisfying other existing criteria. (These are set out in Criteria for the approval of passenger track access agreements, second edition, March 1995.)

Information requirements

To effect this policy approach, the Regulator will look to operators proposing new rights to set out the expected passenger benefits when an access agreement (or modification to an existing agreement) is submitted for approval. The information provided should include an assessment of the expected financial implications of the new service, including abstraction from existing services. The basis of this analysis (in particular, the extent to which it is based on elasticities contained within the Passenger Demand Forecasting Handbook) should be stated. The information will extend that already sought in the context of the proposed access charges, as set out in my letter to TOC Managing Directors of 9 January.

Consultation

In order to understand the implications of new competitive services for existing operators, the Regulator will as explained above generally consult other affected operators and funding authorities before reaching a decision on whether to approve new or modified access rights. The operator seeking these rights should therefore indicate what part (if any) of the analysis provided in support of the proposal is confidential. If the Regulator believes that the proposal raises concerns which cannot be dealt with satisfactorily without disclosure of information regarded by the operator as confidential, he will discuss this with the operator. Where an incumbent operator argues that the new service could prejudice the viability of existing services, the operator proposing new rights will be given an opportunity to respond to the evidence put forward.

Keeping criteria and procedures under review

The approach set out in this letter, which has been discussed with OPRAF, is intended to assist train operators in planning for new services during Stage I of Moderation of Competition. The Regulator recognises that in any particular case a factor may be relevant which is either not reflected in the criteria or is not given appropriate weight. While the Regulator expects this to happen only on rare occasions, he will be willing to consider taking

that factor into account in an appropriate manner where it does. However, before doing so, where a materially different outcome would result, he would expect to consult those affected.

Comments on the approach set out in this letter would be welcome. The Regulator recognises that the criteria and procedures may need to evolve, and revised guidance issued, in the light of experience.

If you have any queries about the contents of this letter, or the information to be provided in specific cases, please contact Phil Smith (Manager, Competition policy, 0171 282 2026).