



OFFICE OF RAIL REGULATION

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19 August 2008

All passenger & freight train operators
All holders of and/or potential applicants for track access rights or track access options
Network Rail Infrastructure Ltd
Transport Scotland
Department for Transport
South Yorkshire, West Yorkshire and Tyne & Wear Passenger Transport Executives
Passenger Focus
London TravelWatch

Dear Colleagues

East Coast Main Line (ECML) and our handling of potentially competing track access applications

A number of interested parties have sought clarification on the approach we propose to take to the assessment of the various potentially competing franchise and open access passenger operators' track access applications on the ECML. Rather than deal with these enquiries in a piecemeal fashion, we thought that it would be helpful to set out our approach in an open and transparent way. This letter describes our intended approach in terms of the "not primarily abstractive" test and the economic assessment.

Background

As the industry is aware, we are currently considering a number of potentially competing track access applications for services from National Express (NEXE), Hull Trains, Grand Central and Grand Northern, together with other aspirations, including those from the freight sector. To inform our consideration of these, we have commissioned Network Rail to produce a capacity and performance report by 19 September 2008 analysing the various applications against the available capacity, and against the background of the anticipated CP4 settlement and the established Freight and ECML RUSs. Our letters to the industry of 16 July¹ and 8 August 2008² set out how we expect this work to be taken

¹ http://www.rail-reg.gov.uk/upload/pdf/s18-ECML_stkhldrs_160708.pdf

² http://www.rail-reg.gov.uk/upload/pdf/s18-ecml_stkhldrs_080808.pdf

forward and the outputs we expect. As part of this process, Network Rail has arranged a meeting with interested stakeholders for Wednesday, 20 August 2008.

In parallel with this work, we continue to carry out our usual processes when considering applications against our statutory duties and published policies. However, it is clear that the issues arising or likely to arise from our consideration of the ECML applications are ones that may not have arisen previously, and as such, we thought that it would be helpful to set out and clarify the approach we will be taking.

Our policy

Our policy on potentially competing track access applications

We have a long-standing policy of not approving rights to new competing services that are primarily abstractive of incumbents' revenue without compensating economic benefits. Such services are often referred to as "cherry-picking" services. Whilst the introduction of any new service is almost certain to bring some benefits to the passengers who use it, cherry picking involves cases where such benefits are more than offset by other factors. For example, cherry-picking makes it difficult for existing passenger train operators to plan their businesses with sufficient certainty and it increases costs for the government and other funders. Our policy on competing services is set out in our final conclusions on moderation of competition, which were published on 18 May 2004³. The policy centres around the application of the five-stage "not primarily abstractive" test. This test considers the ratio of generated to abstracted revenue and the extent to which revenue abstraction is offset by compensating economic and other benefits.

Our current policy on the assessment of competing services does not differentiate between franchised and non-franchised services. However, in the context of the current applications, we thought it would be helpful to set out how we consider that the test should be applied, namely to:

- a new open access service which would compete with franchised services and so impact on the public sector funder's budget;
- a new franchised service which would compete with the existing franchised service of another funder, where there would need to be compensating economic benefits to offset the negative impact on the existing funder's budget; and
- a new service, which might be open access or franchised, which primarily competes with existing open access services. While this would not have a negative impact on public sector funds, we would need to balance all of our section 4 duties. For example, the introduction of competition could have a detrimental impact on an open access operator's revenues, reducing the ability of the open access operator to plan with a degree of assurance (duty 4 (1) (g))

³ Moderation of competition: final conclusions, Office of the Rail Regulator, May 2004, available at <http://www.rail-reg.gov.uk/upload/pdf/195.pdf>

and, if significant, could cause the operator to withdraw from the market, reducing competition elsewhere on the network (duty 4 (1) (d)).

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

Economic assessment of ECML applications

Consistent with our policy and the approach that we have used in the past, we will assess each of the new open access applications against our “not primarily abstractive” test. If we consider that they fail this test then we will not approve the proposed access rights irrespective of the results of our assessment of capacity. We consider that the primary purpose of the new services applied for by NXEC, the franchised operator, is not to compete directly with those currently run by open access operators. We therefore do not consider that these services should be subject to the “not primarily abstractive” test.

If all services pass the “not primarily abstractive” test but there is insufficient capacity to accommodate them at an acceptable level of performance and with acceptable journey times for existing services, then we will consider each of the applications, including those by NXEC, against our section 4 duties. Again, in line with our policy, such consideration will be informed by an appraisal of the relative economic benefits of each of the proposals⁴.

To assist us with the economic appraisal we will shortly be appointing consultants. To ensure transparency and to avoid any duplication of effort (we understand some operators are considering whether to obtain their own economic advice) please find attached a copy of the remit. Briefly, the appraisal will consider the overall economic impact of the services including:

- reduced waiting times from improved service frequencies;
- faster journey times and reduced need to interchange resulting from new direct services;
- reduced crowding from operating additional services;
- change in delays due to performance impacts (if known); and
- road decongestion benefits from passengers transferring from road to rail.

To make this assessment tractable we are focusing it on the weekday services proposed from December 2009. This assumes that: operators would not want to use additional rights granted solely for the period Dec 2008-Dec 2009 unless they continued beyond this period; and that operators would be unwilling to operate services at the weekend unless additional services were available on weekdays (if we consider that a service is justified

⁴ see paragraph 4.35 of our *criteria and procedures for the approval of passenger track access contracts: fourth edition*, Office of Rail Regulation, May 2006, available at http://www.rail-reg.gov.uk/upload/pdf/288-pass_candp4ed.pdf.

from Dec 2009 then those operators that have applied to start from Dec 2008 would be permitted to do so if they are able).

The economic appraisal will consider each of the new service proposals (Hull Trains to Harrogate, Grand Northern to Bradford, Grand Central (fourth path) to Sunderland and NXEC service level commitment 2) against the current service levels. It will also consider:

- the existing NXEC Fridays only service to Newcastle now running under short-term rights (till May 2009);
- the existing Hull Trains seventh weekday return service to Hull, which has only short-term rights, and which we have always said we would reassess when considering longer term options on the ECML; and
- the other six weekday return Hull Trains services between London and Hull, as these rights are due to expire in 2010 and Hull Trains has advised us that it will shortly be submitting an application asking for them to be extended until 2018.

To ensure consistency, all applications will be assessed over a consistent period, although the durations applied for differ in the various applications.

Next steps

Following a competitive tender, we expect to be in a position to appoint consultants by the end of the month. They will be required to produce a draft report by the middle of October in time to inform our consideration on the various applications, which we are still aiming to conclude by the end of the month. A copy of the consultants report will be made available on our website.

In the meantime, if anyone has any comments on our proposed approach to the economic assessment of the various applications set out in this letter, or indeed, any other enquiries, they should – in the first instance – be addressed to:

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LONDON WC2B 4AN

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Given the tight timescales we are working to, it would be helpful to have any comments on the proposed approach by 5 September 2008.

Yours sincerely



David Robertson

Terms of Reference

Appraisal of Multiple/Alternative Track Access Applications on the East Coast Mainline

Background

1. The Office of Rail Regulation (ORR) is responsible for overseeing the fair and efficient allocation of the capacity of the railway network and other railway facilities through our approval of access contracts. ORR has an important role in acting as impartial referee, independent of the Government, in addressing competing claims for access to the network. We can also determine the terms on which a train operator can use the network, where we must act in the public interest, taking account of considerations that may be of little or no concern to individual train operators and Network Rail.
2. In considering track access applications, we must ensure that our decisions are consistent with our statutory duties. Section 4 of the Railways Act 1993 (the Act) sets out a number of considerations and objectives to which we must have regard when exercising our functions under the Act. In some cases, the different duties will not all point towards the same conclusion and ORR will have to balance all of the relevant duties in coming to a decision.
3. ORR has published criteria and procedures that we would expect to follow when dealing with applications for the approval of track access contracts^{5,6}. The criteria and procedure document describes how we intend to deal with track access applications so as to discharge our Section 4 duties and are followed by our staff when dealing with track access applications. The document sets out in detail how for example, we will assess whether there is sufficient capacity to accommodate the rights sought, the performance effects on other operators' services and the net benefits to passengers. The moderation of competition document sets out our policy on, and how we expect to assess, revenue abstraction from existing services where new competing services are proposed (the "not primarily abstractive test"). In summary, we would need to be satisfied both about the impact of approving new rights on the revenues of existing operators (and hence potentially on the budget of the DfT) and that the application is consistent with our criteria for approving track access contracts generally.
4. We have received a number of potentially competing applications for additional weekday track access rights on the East Coast Main Line (ECML) from:
 - Hull Trains, for four daily services each way between Harrogate and King's Cross via York;

⁵ Criteria and procedures for the approval of track access contracts: fourth edition. Office of Rail Regulation, London, May 2006.

⁶ Moderation of competition: final conclusions, Office of the Rail Regulator, London, May 2004.

- National Express East Coast (NEXC), for the rights necessary to operate its proposed Service Level Commitment (SLC) 2 from the principal change date (December) 2009. SLC 2 provides for the following additional services to/from London:
 - a. Lincoln via Newark – six per weekday (including one extended to Cleethorpes)
 - b. Bradford Forster Square via Leeds – an additional fourteen return services (making fifteen in total) per weekday - all extensions of existing Leeds services
 - c. Harrogate via Leeds - a total of six return services per weekday (currently one service to London with no through return service, so extra five inward and six return))
 - d. York – one return service per weekday
 - Grand Central, for an additional (fourth) return weekday service between Sunderland and King's Cross; and
 - Grand Northern, for six return services between Bradford and King's Cross on weekdays; and
 - NEXC, for an additional Friday right King's Cross to Newcastle, which is currently running under a General Approval on a short term basis.
5. In addition Hull Trains are seeking to extend the duration of their existing rights for a seventh weekday return path between Hull and London. When we originally approved these rights we stated that we were “not yet satisfied that granting Hull Trains rights to a seventh Weekday service each way will be the best use of the scarce remaining capacity on the ECML in the longer term. We will therefore consider any request to extend these rights in the context of the ECML [Route Utilisation Strategy] and alongside any requests from any other operators for additional rights. The fact that Hull Trains will have been operating the seventh path will not be a factor in our consideration and Hull Trains must have no expectation that these rights will necessarily be extended.”
 6. Further Hull Trains have submitted a separate application to extend their existing rights (for seven return weekday services) so that they would expire in 2018 (from 2010).
 7. Network Rail is currently identifying whether there is capacity for all of the additional rights.
 8. If Network Rail is unable to accommodate all of the rights currently being sought, we will need to determine what rights should be granted. We are currently reviewing each of the applications against our not primarily abstractive test. We have undertaken some analysis on Grand Central Sunderland services and will need to

update the analysis for Grand Central Bradford services and will undertake analysis for Hull Trains Harrogate services⁷:

9. To enable a decision to be made as to what rights should be approved, we intend to follow two parallel workstreams:
 - A cost benefit appraisal of each of the potentially competing service options, building on work undertaken by each of the applicants and their consultants;
 - Asking Network Rail to carry out initial timetabling work for the ECML to identify which individual or combination, if any, of the access rights can be robustly accommodated.

Objectives

10. The aim of this study will be to undertake a cost benefit appraisal of the potentially competing service options on the ECML. This appraisal will need to distinguish for each of the service options (listed in paragraph 4-6):
 - Revenue abstraction and generation;
 - Journey time savings and other user benefits;
 - The monetised impact on levels of crowding on existing services both at present and assumed future levels of demand arising from the study; and
 - Non-user benefits such as the impact on road congestion.

Specifically taking account of the impact of discounted fares on some of the proposed new services.

11. Other non-monetised impacts should be identified where appropriate and included in a standard Appraisal Summary Table. The appraisal should be undertaken in accordance with DfT guidance⁸. This study is not expected to carry out detailed performance modelling and should draw on the work of Network Rail in this regard.

Approach

12. As it is likely to inform ORR's decision as to what rights should be approved, it is important that the cost benefit appraisal is robust, consistent and transparent in its treatment of each of the service options.
13. The appraisal is likely to rest heavily on the demand and revenue forecasts, particularly in terms of the distinction between revenue generated by the new

⁷ This would be informed by the analysis undertaken or information that becomes available as part of this study.

⁸ DfT guidance on rail appraisal.
http://www.webtag.org.uk/webdocuments/3_Expert/13_Rail/index.htm

service and that abstracted from other services. Our policy is that while it may provide reasonably robust estimates of revenue abstraction, MOIRA may not be able to model accurately the revenue generation of a new service proposition such as those provided by open access operators⁹ as:

- It assumes the average price of tickets is the same for each operator on each point-to-point journey whereas open access may offer some tickets at lower fares than alternative operators,
- The assessment of revenue generation is based only on timetable factors (i.e. journey times, frequency and interchange penalties) and excludes factors such as service quality; and
- It is an incremental model based upon the current demand on the flow, whereas open access operators serve some stations with no existing through services.

14. We would therefore like consultants to propose an approach to estimate reliably and consistently the demand, revenue and economic benefits from each of the service propositions. Previous analysis of earlier potentially competing ECML track access applications was undertaken used the PLANET Strategic Model. It is important to note that at the time of the study it is unlikely that an agreed timetable will be available for each of the applicants.

15. It is envisaged that the study will be undertaken in five stages:

- Stage One: Identify a fit for purpose approach for this study ensuring that any modifications required to models can be made within the timeframe of the study;
- Stage Two: Update or develop the relevant model for the purposes of this study;
- Stage Three: Forecast demand and revenue for each of the service options listed in paragraphs 4 - 6, in isolation and in combination. An appropriate base case should be identified in discussion with ORR. We would expect that a maximum of five combined service tests would be required;
- Stage Four: Undertake the cost benefit appraisal based on DfT guidance; and
- Stage Five: Undertake sensitivity tests on the appraisal results to changes in key assumptions/variables including alternative timetable propositions.

16. We envisage that our staff will play an active role in the study as well as providing key background documents and agreeing key assumptions.

Stage One

17. In identifying whether the approach or model is fit for purpose it is envisaged that at least the following issues are reviewed:

⁹ See Section 4.17 of Application by Grand Central Railway Company Limited for a track access contract, Office of the Rail Regulator, London, June 2004.

- The railway network to ensure that all stations of interest are taken into account;
- The zoning system to ensure that station catchment areas are accurate, particularly where railheading could significantly affect demand;
- Timetables to ensure that they reflect services that would be in operation when the potentially competing options are introduced¹⁰;
- Demand to ensure that it fully and accurately reflects demand for each service option.

Stage Two

18. The proposed model or approach should be developed to ensure that it appropriately reflects existing demand and service patterns.

Stage Three

19. Demand forecasts will be required over a period of five to ten years. It is therefore important that any forecasts are checked against revealed preference data, particularly on the introduction of Hull Train's or Grand Central's open access services (we can provide some data on this), and outputs from other models, i.e. MOIRA forecasts of revenue abstraction. Where impacts have not been explicitly included, for example the effects of enhanced rolling stock, these should be incorporated through off model adjustments.

Stage Four

20. The appraisal of the service options should be carried out in accordance with DfT's guidance on rail appraisal. Individual and combinations of options should be appraised separately and compared to the base. Both monetised and, where appropriate, non-monetised impacts should be identified and included in an Appraisal Summary Table. Standard economic appraisal measures such as Net Present Values and Benefit Cost Ratios should be provided. The study should also identify the distribution of impacts on the main stakeholders. Detailed analysis of some impacts, such as those on performance, will be outside the scope of this study and the appraisal is expected to draw on models and analysis undertaken by others, for example Network Rail. We will supply relevant information during the course of the study as it becomes available.

Stage Five

21. The main risks to the appraisal should be identified and sensitivity tests carried out to ensure that results are robust. Tests should encompass changes in key assumptions/variables such as service timings, values of time, fares (and fares modelling) and key parameters.

¹⁰ we will define the appraisal base case for use in the study

Output

22. We expect work to commence within one week following the closing date for tenders.
23. The key outputs from the project will be:
 - An inception report, which confirm that the modelling approach is fit for purpose and the updates needed to make it so;
 - A draft final report in week [eight] describing the demand forecasts and appraisal results. This should also set out key assumptions and sensitivity tests; and
 - A final report two weeks after provision of comments by ORR.
24. The inception and draft final reports would remain confidential to ORR. However, the Consultant should assume that the final report would need to be published (in a redacted form) and a corresponding standard of presentation is necessary. Supporting spreadsheets and model results should be supplied to ORR at the draft and final reporting stages. Any framework agreement requirements for example for PLANET would need to be met, for example provision of outputs.

Project Administration

[Redacted]