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5th August 2013

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Dear Philip,

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

This letter sets out the views of TfL on the questions raised in the ORR's consultation on options for change in open access. TfL is content for the contents of this response to be published and shared with third parties.

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

The steps proposed will improve the opportunities for open access operations by reducing the barriers to their approval. It is nonetheless important that the NPA test is retained to protect the financial interests of public sector investors in the railway. Public sector funding has helped to drive up service quality on rail in recent years alongside the successes of open access operators. Regulatory policy therefore needs to ensure that that public sector bodies can still invest in the rail network with confidence and not face the risk that the value of their investments will be eroded.

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

Changes to EU law clearly favour open access operations but these will have little impact on Britain given that the structure of the rail industry already

facilitates the commencement of open access operations. Technical developments may provide additional network capacity that could be used to increase open access services. It is important that this objective is balanced against competing claims from other services (primarily local and regional) funded by public sector bodies that could have a superior economic case. Consideration of the economic case must remain part of any process for the allocation of scarce network capacity. Greater devolution of the responsibility for rail service provision in the UK will create a greater diversity of funders; it is important that their interests are collectively protected against excessive abstraction by open access operators.

Q3. What are your views on Option 1? If we were to retain the current NPA test and structure of charges for open access what effect do you think changes to the economics of the railway and to capacity would have on the scope for and levels of open access competition? Do any factors other than those listed above favour (or not favour) Option 1?

Option 1 would retain the status quo and mean no improvement to the opportunities available to set up additional open access operations. TfL considers that there could be value in expanding opportunities for open access operations provided that the interests of public sector funders are fully protected in cases where the NPA test is relaxed, and that the allocation of capacity continues to consider the overall economic case for competing service provision options.

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

Option 2 (a mark up linked to levels of abstraction) is preferable to Option 3 (a mark up based on costs) to TfL, because it provides the most transparent way of ensuring that the financial interests of funders are protected. The mark up should be equivalent to 100% of the value of the excess abstraction, and should be paid (either directly or indirectly) to the funders affected by the abstraction. A mechanism needs to be created to facilitate this, for example through a special access charge supplement. This could be paid until the end of the Control Period when the open access operation commenced, and then incorporated into a reduction to the Fixed Track Access Charge paid (indirectly) by the funders from that point onwards. Funders would need to ensure that they had appropriate arrangements to recover any compensation from their operators during future Control Periods. Network Rail should not be allowed to retain any of the value of the mark up as this would represent a windfall gain for them compared to current arrangements.

The feasibility of the commercial case for any open access operation should be based on its ability to attract new passengers to the rail market through the provision of new journey opportunities that are not offered by franchised or concessioned operations. This ensures that the value of open access operations to the industry is maximised, and also ensures that such operations are less dependent on abstracted revenue and the resolution of disputes related to this.

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

TfL does not support Option 3 (a mark up based on costs) as this does not guarantee that the full amount of the excess revenue abstraction would be covered. This approach could leave existing franchises and concessions at risk of losing revenue, with adverse consequences for public sector funding arrangements and willingness to invest in the industry. This would certainly be the case if Network Rail were allowed to retain the value of the mark up received and funders received no compensatory adjustments to their costs.

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

TfL agrees that the above process would be appropriate for Options 2 and 3;

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

TfL agrees with the suggested approach. Operators and funders whose revenue is adversely affected by open access operations should also have the opportunity to appeal against the mark up if evidence shows that it has underestimated the actual level of revenue abstraction.

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

The process used should ensure that the revenue raised by mark ups is passed through to the affected funder, both in the short and the long term, as they are the ones who will ultimately bear the losses concerned. Such arrangements must also account for the impact of the Periodic Review process. Network Rail must not be allowed to retain the value of any mark up

as a “windfall” gain (in the short or long term); rather they should only retain the income they receive from an open access operator under the current regulatory arrangements governing such operations.

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

TfL does not agree that mark ups should be tailored to address concerns over the initial viability of such services. Open access operators should be required to accept the risk that their operations do not meet their financial targets from the outset, as would normally be the case for any commercial business proposition.

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

Mark ups should be retained at Periodic Reviews, based on the actual level of abstraction recorded to minimise the risk that open access operations are destabilised. They could be used to reduce the fixed track access charges paid by operators suffering excess revenue abstraction. Operators should be required to pass the associated savings on to the funders who ultimately underwrite their operations.

Yours sincerely,

**Alan Smart,
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Rail Planning team.**