RESPONSE TO THE OFFICE OF RAIL AND ROAD's CONSULTATION ON THE EMERGING FINDINGS FROM ITS RETAIL MARKET REVIEW

ASSOCIATION OF TRAIN OPERATING COMPANIES AND RAIL DELIVERY GROUP

21st September, 2015

1 Introduction

We welcome the opportunity provided by the Office of Rail and Road ('ORR') to comment on the emerging findings and potential remedies from its Review of the Rail Retailing Market ('the Review').

This response to the ORR's consultation on its emerging findings is the result of close collaboration between ATOC and its train company members, and the response represents their collective view.

ATOC/RDG is happy for this response to be made public and published on the ORR's' website.

Our response is designed to form the basis for further, detailed engagement between ATO/RDGC, Train Operating Companies ('TOCs') and the ORR. In particular, we would be happy to work with the ORR on development and implementation of the nearer term remedies identified in the consultation document, many of which we support.

Similarly, we would be happy to work with the ORR and other stakeholders, particularly the DfT, on the possible longer term remedies identified in the ORR's emerging findings.

We have focused our response on the specific questions raised by the ORR in its consultation document, and have not commented more widely on the rail retailing market, given that we have already made substantive submissions to the ORR on wider market issues. This consultation response should, therefore, be seen as complementary to our earlier submissions.

We have noted but generally but not commented on the initial impact assessment conducted by the ORR and set out in annexes C and E. We welcome the fact that an impact assessment has been conducted, but note that it is necessarily high level and indicative at this stage. We would be happy to engage with the ORR on completing of a more detailed impact assessment prior to the implementation of recommendations.

2 Key point summary of our response

Market Overview

- In general, we agree with the descriptions of the retail market set out by the ORR, but believe that the extent of change in the market over recent years has been under-emphasised, as has the generally high levels of customer satisfaction with industry retailing.

- We were surprised that some elements of regulation, particularly the current constraints on changes to station ticket offices, were ruled out of scope, given the clear market distortion such regulation constitutes, and the fact that some of the more significant potential benefits should the Review's emerging conclusions be implemented are dependent on reform of this aspect of the regulatory framework.

Near term conclusions and remedies

- We agree that TOC incentives to introduce new products are limited and highlight the role of regulation and franchising policy in creating such constraints.

- We believe that TIS can be an important differentiator in the market, particularly the internet retailing market, but less so in the station retailing channel. The quality of TIS in the internet market is high, and competition has been effective in driving innovation. This has not been the case as far as the station retailing channel is concerned, and we believe than an element of central direction is needed to address current market failure.

- We support the proposed changes to governance arrangements for third party retailing, and believe that a package of measures should be introduced, including the appointment of an independent member to ATOC's Customer Experience Board, the publication of additional information by ATOC/RSP, a formal consultation period ahead of changes to key commercial terms, and a periodic review of third party retailing arrangements by an independent review body.

- We believe that the existing dispute process within ATOC licences may provide an appropriate way for third parties to raise disputes, but highlight the potential for duplication with the work of the independent review body. We suggest ways that this could be addressed.

- We support the possible extension of the third party retailing market to smaller retailers, an opportunity which ATOC is already actively investigating, and would be open to initiatives that encouraged smaller retailers to enter the market, such as the relaxation of the impartiality requirement.

- We were puzzled by the conclusion that the current ATOC licence constrains the ability of third parties to compete in the market as a result of limitations on the range of products that third parties are allowed to sell.

- The only material preclusion at the moment is related to Season Tickets, and a trial is currently underway to assess extension of the third party retailing market to include Season Tickets. Subject to successful conclusion of the trial, Season Ticket retailing will be extended to all third party retailers during the course of 2016. Other excluded products represent just 0.2% of rail revenue, and all are excluded for specific reasons.

- There is no collective train company policy on those TOC online discounts or TOC-specific products that are not made available to third party retailers. Train company approaches on this issue vary and ATOC has no basis on which to provide a collective view. The issue will be dealt with in individual train company responses.

- We don’t agree that train companies only have limited incentives to create central IT systems and services. Since privatisation, train companies have significantly expanded the range of central systems and services, and have been innovative in finding ways to fund this expansion and recover costs.

- The continued expansion of NRE services and the current RSP modernisation programme both reflect the effectiveness of collaboration in this area.

- We do not support the idea that the government should lead the development of a future national ticketing strategy, and are very surprised that the consultation document does not make reference to the RDG-led initiative in this same area, which is ongoing and well advanced.

- The RDG initiative has been deliberately based on a multi-stakeholder approach, which has proved, thus far, to be a successful in developing the necessary concensus and alignment for a national strategy to work. The emerging national strategy is based on the replacement of paper ticketing by smart, digital ticketing.

- Whilst we believe that innovation funding has a role to play in industry retailing, it can most effectively make a contribution by creating a market stimulus for the take-up and development of new technologies. We also highlight issues with the current efficacy of innovation funding mechanisms.

- We welcome, in principle the involvement of third party retailers in the development of shared industry systems, but highlight that extensive engagement already takes place. We would be open to specific ideas for change or improvement, where there were strong supporting arguments.

Longer term conclusions and remedies

- We believe that differential pricing by channel potentially offers some very significant opportunities, in particular the potential to reflect the relative costs of retailing for each channel in the price offered to customers, with a view to encouraging migration to lower cost channels.

- However, the potential for cost reduction from differential pricing by channel, whilst substantial, will only be realised if current regulation is changed. There are also other issues that would need to be addressed, including the risk of exacerbating perceptions of fares complexity and the impact on the third party retailing market.

- Overall, we agree strongly that differential pricing by channel should be considered further.

- The creation of a wholesale market far rail fares using the kind on net pricing approach used in Sweden (or a similar approach) is an interesting idea. However, there are significant issues that would need to be addressed including: the risk of exacerbating issues around the complexity of fares; the effect on the current impartiality obligation; and the potential impact on industry central and retail systems.

- Overall, we believe that this longer term remedy is worth considering further but are sceptical that it will provide overall benefit. Given that in Sweden, net pricing seems to have had only a limited effect, a better understanding of the experience of net pricing in the Swedish market would be a good starting point.

- We strongly support a review of the current regulatory framework, including those elements of the framework, which are designed to emulate the existence of a single, integrated national rail network.

- We advocate that such a review needs to begin by considering the market model, which regulation is designed to support, and should take a holistic view, including the role of franchising policy

3 Responses to questions posed in the ORR's consultation document – questions from chapter 1

3.1 General comments on the chapter

We have no general comments on this chapter, which we felt provided a good overview of the retail market. We have responded to the specific question raised at the end of the chapter below.

3.2 Question 1: Do you agree with our description of the market for ticket selling?

We have no significant issues with the description of the market for ticket selling described in chapter 1, but would have highlighted more strongly the role of the regulatory framework, which underpins much of the collaboration in the market.

We were particularly surprised to see the current regulatory constraints on station ticket office retailing (particularly Schedule 17 of the TSA) effectively ruled out of scope as being a matter for government (footnote 10 on page 16). We remain of the view that this constitutes a significant distortion of the rail retailing market, and, as such, could reasonably be considered by a Market Review being conducted by the industry's independent Regulator.

We agree that the co-existence of competition and collaboration creates a degree of tension in the market. In this context, it would be interesting to disaggregate those collaborative elements of the market driven by regulation, and those driven by other factors such as economies of scale in procurement.

However, overall we believe that both competition and collaboration have important roles to play in the market, and that regulation, if correctly designed, can be used to support an efficient market model based on an appropriate balance of competition and collaboration.

However, the current market model has evolved over time rather than being created by design, and that a review of the regulatory element of the market, in particular, is overdue. We comment on this issue further in our responses to later questions in the ORR's consultation document.

4 Responses to questions posed in the ORR's consultation document – questions from chapter 2

4.1 General comments on chapter

We do not have any general comments on this chapter, which we thought provided a good overview of the current market. We have responded to the specific question posed at the end of the chapter below.

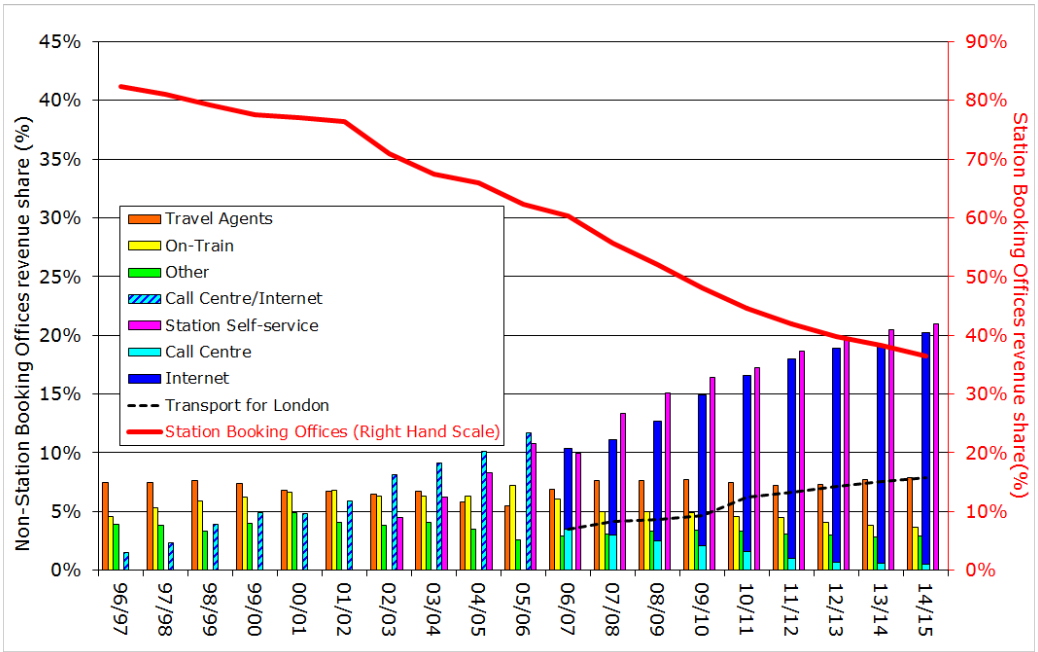
4.2 Question 2: Do you agree with our emerging findings with respect to passengers' ticket buying experiences regarding their choice/ability of a) retailer/sales channel; b) how they buy their tickets; c) their ticket format; d) the range of tickets; and e) opportunities to find cheaper prices?

In general, we agreed with the emerging findings as described in chapter 2, but had a number of specific comments and observations, which are set out below.

Choice of retailer/sales channel

We believe that the emerging findings under-emphasise the extent of change in the market, over the last ten years in particular. Figure 1 below illustrates trends since privatisation, in particular the steep and continued decline in station ticket office retailing and the concomitant growth in internet and TVM retailing.

Figure 1: Proportion of rail industry passenger revenue by sales channel 1996/7-2014/15



The 'traditionally' predominant channel, station ticket offices, has seen an absolute fall in the volume and value of sales, despite station ticket office retailing capacity being maintained at roughly constant levels due to the regulatory framework.

Instead, customers have migrated in significant numbers to TVMs, particularly for shorter distance, low value journeys. In London, Oyster PAYG has proved to be the channel of choice for increasingly large numbers of customers.

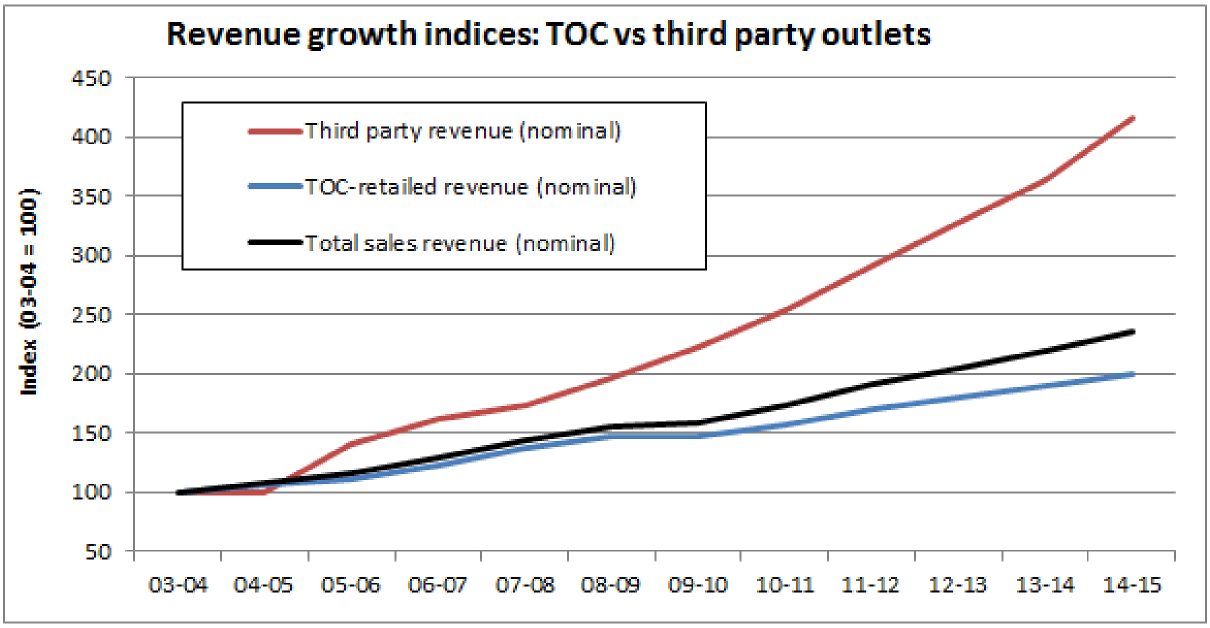
In longer distance markets, customers have increasingly opted for the internet, particularly in the leisure market. This has partly driven the convenience of this channel, but the growth in Advance fares (particularly well suited to purchase over the internet) and ToD/barcode ticketing has also made purchasing at home much more convenient. In the longer distance business travel market there has also been migration to the TMC channel.

Given that station ticket office retailing capacity has remained fixed, these significant changes in ticket-buying patterns are essentially customer-driven reflecting that TVMs, the internet, PAYG and TMCs represent easier and more convenient methods of ticket purchase.

Whilst there has been significant change, normal market dynamics have, nevertheless, been distorted by station ticket office regulation. Without the constraining factor of this regulation it is likely that even faster migration away from station ticket offices would have been seen, as the business case for investment in alternative channels would have been stronger.

A further feature of the market has been the growth in third party retailing, as illustrated by figure 2 below.

Figure 2: Relative growth in TOC and third party channels 2003/4-2014/15



Source: Rail industry Lennon information system

Over the last ten years, non–TfL third party sales grew by 207% in real terms compared to 38% growth in sales through TOC outlets. TfL sales have increased by 326% in real terms.

In summary there has been a considerable increase in both choice for consumers (a wide range of new TOC and third party online retailers, Oyster and CPAY PAYG in London, and a very significant expansion in the number of TVMs at stations) and competition between retailers.

It is worth noting that this expansion has been supported by the co-operative arrangements between TOCs in terms of the IT infrastructure and commercial framework that supports retailing.

Paragraph 2.6 highlights the limited choice of online retailers. However, we are not clear what evidence supports this conclusion. There are currently five fully licenced internet retailers (the Trainline, Redspottedhanky, Raileasy, Assertis and Silver Rail) and this number looks set to expand over the next few months as TOCs agreed to award licences to two further retailers (Click Travel and GTV) in July 2015, and with a further potentially substantive player showing very active interest in market entry. We expect to see seven or eight licenced internet retailers trading in the market by mid-2016.

It is also worth highlighting that licenced internet retailers are allowed to sub-licence and appoint affiliates, effectively extending their reach quite considerably. ATOC exercises only limited control over this process (the licenced retailer is responsible for the actions of their sub-licencees or affiliates), which has meant that the number of internet sites offering rail has increased significantly.

This is a highly competitive market compared to the rail markets in other developed countries, where typically there is little or no presence in the market in terms of third party internet retailers (there is only one third party internet retailer in the French market for instance).

More relevant questions in our view are the number of internet retailers the market can support and the kind of players we want to see. Our own judgement is that the market can probably support 3-4 major retailers in addition to TOCs. At the moment, whilst we have achieved this in terms of the number of players, there is a significant disparity in terms of size, with the Trainline dwarfing its competitors.

In a market where there appear to be economies of scale and where there is a need to invest heavily in marketing to compete effectively, Trainline's size provides it with a strong advantage compared to challenger retailers. We have previously tried, unsuccessfully, to attract major new players capable of effective competition into the market and it remains an open question as to how we can expand competition and consumer choice further through development of a more balanced market.

Finally, we fully support the conclusion that there is potential to expand choice by extending retailing to smaller retail outlets. ATOC is in active discussion with a number of potential retailing partners in this area, and the option of a new form of licence to support this form of retailing remains a possibility.

There is also likely to be some collateral benefit for smaller retailers from the industry's emerging ticketing strategy, where the removal of the need to print physical tickets, will remove a significant technical (and financial) barrier to entry. We consider this opportunity more fully in our response to question 7.

How passengers buy tickets and ticket formats

We agree that improvements need to be made to TVMs to provide better and clear information for customers, and we accept that there is a substantive body of research evidence that supports this conclusion.

As such, TVMs have been the subject of much effort at an industry level, with the recent publication of the TVM Design Guidelines by ATOC, and the network-wide labelling of machines to provide more information to customers. However, whilst we fully accept that more needs to be done, there are significant challenges to driving forward improvements, not least the difficulty for both TOCs and TVM suppliers in making the business case for major investment, particularly given that the emerging strategic focus on digital ticketing means that TVMs are unlikely to be needed over a 5-10 year horizon.

We are less convinced by the conclusion that the same sorts of issues apply to internet retailing, and are not aware of a substantive body of evidence to support this conclusion. In our view both TOC and third party internet retailers provide good quality information and high degrees of usability, both of which allow customers to make well informed decisions about ticket purchase. Indeed we believe that the increase in ticket purchase through this channel has been one of the key drivers of industry growth in recent years.

We were also puzzled by some points of detail in the ORR's consultation document. In paragraph 2.15, we were confused by the apparent implication that Oyster top-ups (including auto-top-ups) only applied to TfL services, whereas such top-ups can be used to purchase National Rail, TfL and joint products. Furthermore, train companies also offer top-up facilities at stations, primarily through their TVMs.

Similarly footnote 43 suggests that rail customers aren't able to reserve specific seats when making a booking, whereas some longer distance train companies such as Virgin Trains East Coast and Cross Country Trains do offer this facility on their own services.

In general, whilst we accept that improvements are needed to TVMs in particular, it is worth noting that customer satisfaction with retailing in general certainly seems to be quite high. Table 1 below provides a summary of data from the National Rail Passenger Survey dealing with ticket purchase, broken down by retail channel. The results are based on the two waves of NPS research in Autumn 2014 and Spring 2015.

Table 1: Passenger satisfaction with ticket buying facilities

Purchasing channel:	% of passenger who rate ease of purchase as very or fairly good
Internet	90.3%
Travel agent	89.1%
Station booking office	86.6%
Call centre	80.2%
Ticket vending machine	81.8%
Smartcard	78.4%
On train	78.5%
Overall	**82.7%**

Source: National Rail Passenger Survey, Transport Focus

These results are broadly mirrored by ATOC's own annual mystery shopping and customer satisfaction survey work, the most recent results of which, from 2014, have been summarised in Table 2 below.

Table 2: Levels of accuracy and customer satisfaction by retail channel

Channel:	% of tickets sold accurately	% customer satisfaction	Confident purchased correct ticket	Satisfaction with ease of use
Station TOs	95%	-	-	-
TVMs	91%	-	95%	-
Internet	94%	89%	99%	91%
Notes	1954 TO shops, 200 TVM shops, 400 internet shops	based on % of respondents who would recommend the website to others		

Source: ATOC annual mystery shopping and customer survey 2014

The level of customer satisfaction with internet retailing was in line with that found by the NPS at 90%.

Ticket formats

As far as ticket formats are concerned, our earlier submissions to the Review have emphasised this as a key area of challenge for the industry. We will not repeat those arguments here but would again highlight that there is a stark contrast between Greater London and the rest of the county. Oyster PAYG and now CPAY has established the former as a world leader in terms of ticketing, whilst cardboard/magnetic strip, CCST tickets remain the predominant ticketing format in the latter, a position unchanged for around thirty years.

We, therefore, support the conclusions in the consultation document, but are very surprised that no reference was made to the major RDG initiative to tackle this issue, which we have referred to in our previous submissions and briefed the ORR on separately.

This initiative was based on the premise that a multi-stakeholder strategy was needed to address the issue, given the need for ticketing to be inter-operable, and the significant dependencies on station platform gates and other infrastructure. In this context, RDG working closely with the DfT, TfL, PTEs and other stakeholders has developed a future strategy based on migration from paper tickets to digital tickets.

The emerging strategy is based on the extension of smart PAYG schemes in urban areas and m-ticketing using barcode technology for the rest of the network (the latter following-on from the recent ATOC/Trainline-led m-ticketing trial).

A high level business case and delivery road map have been developed, and it is planned to seek Ministerial approval for the strategy in the autumn. We comment further on this issue in our response to question 9.

Passengers' choice of tickets

We agree that a choice of fares is important, but would note that train companies are frequently criticised for issues associated with the perceived complexity of fares. Whilst, we would accept that some of this criticism is (rightly) focused on the way that information is presented (which creates the perception of complexity), an element nonetheless is based on there simply being too many fares.

There is clearly a balance between choice on one hand and complexity on the other, which is why train companies have voluntarily maintained a consistent national fares structure, which offers a range of fares, since fares simplification in 2008. This approach has sought to provide reasonable choice whilst avoid unnecessary complexity.

We also believe that fares need to evolve over time in line with developing markets. A good example is the commuting market, where we agree that there is an emerging market for new types of commuter products, based on the move away from five day a week, 9-5, office-based working patterns.

However, the ability of train companies to create new products is, in effect, constrained by a number of factors, which we describe in our response to question 3.

On a point of detail, we were not clear about the conclusions emerging from the analysis in box 4 and figure 5. Inter-available fares (Anytime and Off Peak fares) are essentially the core fares offered to customers for much of the network, and we believe they are not generally chosen by customers because of their inter-availability, but because they are the only or cheapest fare available at the time at which the customer wished to travel.

Passengers' opportunities to find different/cheaper fares

We were not surprised that the ORR's research found that customers were surprised that retailers sell at broadly equal prices across sales channels. Third party retailing advertising, in particular, strongly implies that buying online is cheaper than purchasing at stations. This has led to tension in the past where train companies felt that third party advertising was sometimes misleading consumers. Ultimately, we understand that guidelines were laid down by the Advertising Standards Authority.

In general, the internet has been transformational in providing customers with better access to fares information. Given the widespread information available, price comparison websites have not emerged in the rail market, although the role of National Rail Enquiries, as an industry-provided source of price comparison information, should be noted.

On a separate point, we agree that differential pricing by channel offers potentially very significant opportunities, particularly the ability to allow price to better reflect costs. We comment further on this issue in our response to question 5.

5 Responses to the questions posed in the ORR's consultation document – responses to the questions in chapter 3

5.1 General comments on the chapter

We do not have any general comments on this chapter. We have responded to the specific questions posed at the end of the chapter below.

5.2 Question 3: What are your views on the emerging findings that TOCs' incentives to introduce new fares and products are somewhat limited? What are your views on our suggestions around DfT's role and, more specifically, the role of franchising? What are your views on our proposed recommendations that improvements be made to the industry processes to make it easier for TOCs to introduce new fares or products? Specifically, do you agree that this should be taken forward now, as a matter for TOCs and governments?

We agree that TOC incentives to introduce new fares and products are somewhat limited.

The consultation document correctly highlights the role that franchise tendering plays in introduction of new fares and products, although we would note that even this process is often guided by the franchise specification issued by the DfT.

Within franchise terms, incentives to create new fares and products are constrained by three key factors:

- The strict financial requirements within franchises, which typically involve the payment of significant and increasing premiums to Government, or significant and increasing reductions in subsidy, both of which very substantially reduce the scope for innovation where there is a risk of revenue loss;

- The complex regulatory framework within which fares are set including fares capping, the requirement to offer Off-Peak return fares on longer distance routes, the requirement offer through and inter-available fares for every point to point flow, and the highly prescriptive rules for fares' setting contained in the Ticketing and Settlement Agreement, all of which constrain the ability of train companies to introduce new fares and products (for instance by adjusting the price of other products to offset the risks associated with a new product);

- The strong stakeholder pressure to offer a consistent range of fares on a national basis that simplify choice for customers, that led to fares simplification in 2008, and the maintenance, on a voluntary basis, of a consistent national fares structure since then.

One nuance to this analysis that we would note is that the factors identified affect TOCs to different degrees. In particular they tend to constrain TOC-led innovation in commuter and regional markets, where franchises are more tightly specified and more fares are regulated. Longer-distance TOCs are still materially affected by the factors identified but have relatively more ability to take risk and innovate.

It is worth noting that the factors identified above tend have less impact on the development of collective products developed at a national level. This is reflected in successful collaborative initiatives such as the Two Together Railcard or re-designed Gold Card for annual Season Ticket holders.

Against this backdrop, the DfT has taken an increasingly active role in setting fares policy both in a general policy sense and more specifically at route level through franchise specifications.

In this context of the factors identified above, we agree that that the role of franchising (and the DfT) should be considered further in terms of encouraging innovation, but note that this requires some fundamental re-thinking of both franchising policy and the regulatory framework if current constraints are to be materially reduced. This point applies particularly to ‘within franchise’ innovation.

We agree that consideration should be given to streamlining and simplifying current industry processes for the creation of new fares and products, but believe that this is unlikely to fundamentally alter the current position, given the more significant constraining factors already identified.

5.3 Question 4: What are your views on the role TIS machines play in enabling TOCs to differentiate the way they sell tickets to passengers? What are your views on the appropriate response, in particular around the balance between providing the TIS market with more direction about the design of TIS machines and in facilitating choice?

TIS are an important differentiator in the internet market, and to a lesser extent in the TVM market.

In the internet market, the usability of websites and the extent to which they provide good quality information are important differentiators in the market, and we believe that competition between retailers in the consumer market, as well as in the market for the provision of ‘white label’ sites, has been effective in driving innovation and improving quality (although it is worth noting that train companies would like to see more suppliers active in this latter market). This is reflected in the high levels of customer satisfaction with internet retailing already highlighted.

The TVM market (and station TIS market more generally) has been less effective at driving innovation, with a limited range of suppliers, and a market that is probably insufficiently large or stable to justify risk-based innovation by suppliers. Innovation is, therefore, largely TOC rather than supplier-driven, but relatively small manufacturing runs tend to result in high costs, making it difficult for TOCs to justify the necessary investment.

These problems are exacerbated by the fact that station TIS are not designated franchise assets, meaning that have no residual value to franchisees at the end of franchises. This again makes investment harder to justify, particularly in the context of relatively short duration franchises or franchise extensions. It is particularly difficult for franchisees nearing the end of their franchises.

Finally, we should highlight again that the inability of train companies to reduce costs as a result of current regulation is also a material factor impacting on investment in retailing, particularly innovative investment, where business cases may be more marginal.

However, we believe the main impact of the supply-side issues in the TVM market is on customers, and their ability to make informed choices through TVMs that provide user-friendly interfaces and good quality information, rather than the impact on competitors being able to differentiate themselves in the retail market.

In terms of central direction versus individual supplier innovation, we do not believe that central direction is required in the webTIS market, where market mechanisms have been effective in driving innovation and quality,

In terms of station TIS, TVMs in particular, the position is less clear. The current approach is to rely upon individual TOC/supplier initiatives, but this has been ineffective in driving innovation and improvement. The recently published ATOC TVM Design Guidelines were, in many ways, a response to market failure, and a form of central direction (or, at least, encouragement) to correct this failure.

In principle, we would always generally favour innovation driven by competition, but believe that in some circumstances, such as the station TIS market, industry structures may not be capable of supporting a fully effective market, and that a degree of central direction may, therefore, be required to achieve desired outcomes – innovation and higher quality in particular.

However, it is not clear at the moment what the appropriate balance between market-driven change and central direction in the station TIS market should be. This is the subject of an ongoing debate and a better understanding of the current constraints on innovation and change, as they affect both TIS suppliers and TOCs, is needed before conclusions can be drawn as to the nature and extent of central direction required.

5.4 Question 5: What are your views on the possibility that the price of (permanent) fares could vary by sales channel? What are the merits of considering this further at this stage?

We believe this to be an interesting idea and would strongly support its further consideration. As part of its lobbying to reform the regulatory framework, ATOC has argued for some time that differential pricing by channel should be considered.

It is worth noting that differential pricing by channel already exists to an extent in Greater London, where point to point fares are cheaper if purchased using Oyster PAYG or CPAY, with more expensive fares payable for paper tickets purchased through ticket offices or TVMs.

Differential pricing by channel will potentially allow the relative costs of different channels to be more fully reflected in the fares offered to customers. As such, customers will be incentivised to use cheaper channels, and the resulting migration away from more expensive channels would provide the opportunity to reduce costs. With annual industry retailing costs totalling around £500m, the possible reduction in industry costs is potentially very significant.

However, for such cost savings to be realised, there would also need to be changes to other aspects of the regulatory framework, most notably the current limitations on changes to station ticket office opening hours.

In this context, it is also worth noting that migration away from higher cost channels provides the opportunity to re-deploy staff onto other customer-facing duties, and/or to re-invest cost savings in enhanced customer facilities such as improved TVMs. Indeed, as we have already emphasised, the ability to more easily realise cost savings would allow the business cases for investment in innovation or improved services/facilities to be made more easily.

It is worth noting, that differential pricing by channel and the commercial behaviours resulting from it would be considered the norm in most, unregulated industries.

However, we also acknowledge that there are other issues associated with differential pricing by channel that need to be considered, Perhaps the most important of these is the risk that it exacerbates current customer perceptions that rail fares are overly-complex, although we believe that this issue is addressable.

How differential pricing would work in the context of the third party retailing market also needs to be considered, given the potential for 'level playing field' type disputes. At this stage we have no specific proposals to make but would be happy to engage further with the ORR on this issue.

Finally, we would also note at the outset that it is difficult to escape the intuitive conclusion that station ticket office and call centre retailing would be likely to emerge as the most expensive channels, based on costs. The potential consumer issues around this also need to be considered, although it is worth re-iterating the precedent already set in Greater London.

On a point of detail we were confused by the caveat around 'permanent' fares, as there is no reason in principle why differential pricing by channel should not apply to temporary or promotional fares.

On a related note, we would suggest that the charging of transaction and other retailing fees by train companies should be considered at the same time as differential pricing by channel. TOCs are generally prohibited from charging additional fees, as the DfT has consistently interpreted this as non-compliant with the TSA. This has meant that TOCs have not been able to charge fees of any kind, including credit card fees, for station retailing (either ticket office or TVM), on-train retailing, or sales through the internet and call centres.

Once again TOCs have long-argued that they should be allowed to charge fees. TOCs, through ATOC, lobbied intensively from 2004 onwards for complete reform of the TSA, including the abolition of regulatory restrictions on the charging of fees.

Fees also potentially allow the relative costs of different channels to be reflected in the overall price paid by the customer, and would also incentivise customers to migrate towards more cost-effective channels.

It is important to note that we are not arguing for standard fees to be introduced on a uniform basis across all TOCs or specific channels. Rather we are arguing for the freedom for TOCs to charge fees on an individual, discretionary basis at whatever level they thought appropriate (subject to the normal constraints of consumer law).

6 Responses to questions posed in the ORR's consultation document – responses to the questions in chapter 4

6.1 General comments on chapter

We agree that third party retailers bring benefits to the rail retailing market through increasing consumer choice, providing competition that drives up quality and incentivises innovation, and through expanding the reach and size of the market.

As such we support many of the emerging conclusions in chapter 4, particularly around the strengthening of current governance arrangements.

However, we have concerns around some elements of the analysis completed by the ORR. In this context, we comment below specifically on paragraph 4.7, where we believe that some conclusions are unsupported or contradicted by evidence we have previously provided, and where we would challenge the validity of some comparisons.

Paragraph 4.7 states that third party retailers account for 17% of 'gross receipts'. This is at variance with table 1 of the consultation document, which shows third party retailers accounting for 22% of industry sales, broadly in line with our own estimates. It is also worth noting that if TfL sales are included, then the third party share of industry sales is 30.5% of the total. TfL is not a franchised train company or open access operator, so we do not understand why sales through TfL channels or its licenced affiliates such as newsagents and other small retailers, do not count as third party sales?

We would also highlight that table 1 of the consultation document shows the third party share of the long distance market to be 47%. This is a more valid comparison with the aviation market, and a better indicator of third part involvement in the rail market more generally. The rail commuter and regional markets tend to be characterised by shorter distance, lower value journeys, where customers are far more likely to purchase their ticket at the station from a ticket office or TVM, or, as in London, simply use PAYG in conjunction with Oyster or CPAY, which does not require a specific retailing transaction at all.

We were confused by the comparison of the rail retailing market with the energy market and, in particular, the comparison between third party retailers in the rail market and price comparison websites in the energy market. Price comparison websites do not provide a retailing service but rather, in effect, fulfil the role of the impartiality obligation in the rail market. As such we do not believe the comparisons drawn are valid.

It is also worth noting that the impartial retailing obligation applies to the vast majority of rail retailers, meaning that comparative price information is much more widely available in the rail market than the energy market.

In terms of the number of third party retailers in the market, we have already commented on the extent to which the rail market can support a more extensive range of internet retailers. However, we would re-iterate that we believe the number of internet retailers is likely to expand over the next twelve months following the two recent new licencing arrangements that ATOC has entered into, and the ongoing discussion with a third prospective new entrant.

The concentration of sales in the TMC market through a small number of large TMCs would seem to reflect the more general structure of the TMC market, where there has been considerable consolidation around larger market players in recent years, so we are unclear what point is being made in terms of the top ten rail-licenced TMCs accounting for 81% of revenue. The implication seems to be that the TMC rail market is different to the general TMC market but no evidence is provided to support this implication.

In terms of market entry, the use of evidence to support conclusions does not take fully into account the evidence previously submitted by ATOC. Whilst it is correct that there has been a twofold decline in the number of TMCs over the last ten years, as our earlier submissions have made clear, this reflects the general re-structuring of the travel agency/TMC market and, in particular the decline in the number of 'High Street' travel agents, as well consolidation through mergers and takeovers.

We also made clear in an earlier submission, that around 95% of the top 50 TMCs by sales (which, we suspect, account for the vast majority of the market, given the consolidation that has taken place in recent years) are already rail licenced, meaning that the scope for the entry of material new players is very limited. Despite this, there have some new TMC entrants into the rail market. Over the last five years from 2010 to 2014 inclusive, around five TMCs a year have, on average, entered the market.

Given the above, we would challenge the ORR's conclusion 'that there does not appear to be significant new entry'. We would also re-emphasise that, as set out in detail in our previous submissions, licenced third party retailers already in the market have enjoyed growth higher than the market average over the last ten years.

We have responded to the specific questions raised at the end of the chapter below.

6.2 Question 6: 'What are your views regarding our emerging findings on the incentives potential and existing retailers face in entering and expanding in the market? Specifically, what are your views around having an independent body overseeing the third party retailers' arrangements, including the identity of the body; or having greater transparency of retailers' likely costs and remuneration; on having a formal obligation on the relevant TOC governance bodies to consult on significant changes to the industry regime; and on having an appeal mechanism to enable a third party retailers raise a dispute?'

We have provided in our previous submissions detailed evidence on the growth of the rail market, and the above average growth of third party retailers. We have also set out detailed evidence on the market entry, licencing and other requirements placed on third party retailers, highlighting that we believe such requirements to be reasonable and fair, although making clear that we would be prepared to address any specific requirements felt to be disproportionate.

We were not entirely clear from the consultation document what the ORR's emerging finding were with regard to 'the incentives potential and existing retailers face in entering and expanding the market'. We note that the ORR has 'not identified any obvious problems with the particular entry requirements' set by TOCs through ATOC.

In this context, we would also highlight that TOCs, acting through ATOC, have never rejected a licence application from a third party retailer.

However, we also note that the ORR is concerned about potential conflicts of interest, which it believes undermines the confidence that third party retailers have in current arrangements. It further believes that the lack of transparency around current governance arrangements exacerbates this problem.

We agree that there is a potential conflict of interest in terms of TOCs both licencing third party retailers through ATOC, whilst simultaneously competing with them in the rail retailing market.

However, as we have previously emphasised, whilst TOCs compete with third party retailers in the retail market, they are fundamentally carriers, not retailers, and have a strong vested interest in maximising sales, through whatever channel. As such they have a strong commercial imperative to ensure that third party retailers are incentivised to maximise sales. This significantly diffuses the potential conflict of interest highlighted in the ORR's consultation document.

Furthermore, ATOC/TOCs go to very considerable lengths to be even-handed in the way that they deal with third parties. TOCs and ATOC are mindful of competition law in particular and consider this explicitly when making decisions.

As stated in our earlier submissions and highlighted in the ORR consultation document, ATOC, in essence, performs a quasi-regulatory role in the market, which it takes very seriously. Our earlier submissions have set out in some detail the background to and rationale for current licencing and commercial arrangements, and we will not repeat them here.

In this context, it is also worth re-iterating the point made in earlier submissions that, although not required to by the regulatory framework ATOC/TOCs do consult with third parties on key changes, such as commission, although agreement on issues like reductions in commission is unsurprisingly very difficult to achieve. The sheer number of third parties also makes consultation more difficult, with the larger retailers and trade associations inevitably being the main focus of discussion.

In this context, it is worth re-capping again the kind of consultation that has taken place over the last two years around the planned forward strategy for third party retailing. This has included: a significant joint piece of work with the Trainline to assess the value provided by third party retailers; presentations to Commercial Board by Redspottedhanky, the GTMC, Advantage Travel Group and the Trainline; a presentation to and debate with the GTMC's Surface Transportation Working Group; a presentation to and evening dinner with the top twenty TMCs; individual dialogue with a number of key players particularly the Trainline, and six meetings of a joint TOC/ATOC/TMC working group, set up to consider the strategy.

It is perhaps also worth re-iterating that commercial tensions of the kind seen in the rail market exist in many, if not most, other markets. When the airlines reduced commission at the turn of the century it created enormous controversy and market tension in that sector of the travel market. We accept that there are some specific features of the rail market that contribute to tensions but the rail market is certainly not alone in experiencing differences of view on key commercial issues.

Nevertheless, we accept that current governance arrangements are insufficiently transparent and exacerbate concerns about potential conflicts of interest, and are keen to reduce market tensions, where it is reasonable to do this. We, therefore, support many of the proposed remedies suggested by the ORR, a number of which are based on ideas put forward by ATOC/TOCs.

However, we do not believe that any single measure is likely to be sufficient and suggest that a package of measures be adopted. We have summarised below, what we believe a potential package of measures could include:

(1) Appointment of an independent member to ATOC's new Customer Experience Board, which will take over the role of Commercial Board from September onwards. We believe that an individual with a transport economics/regulatory background, completely independent of the TOC community, may well be able to provide additional challenge and insight. However, we note and accept the ORR's comments on the necessary limitations of

the influence of such an individual, and that such an initiative on its own would be insufficient.

(2) Publication of the rationale for key commercial terms for third parties on the ATOC website, including commission and RSP costs. We have already made the rationale public in our earlier submissions to this Review and would be happy to publish it on the ATOC website, alongside the information on commission and remuneration that we already publish.

(3) Provision of additional information on the ATOC website about the standard costs of licences and other costs that would accrue to third party retailers, such as RSP costs.

(4) The establishment of standing working groups with third party retailers, noting that a standing TMC working group has already been established, and that regular, individual account meetings already take place with key internet retailers.

(5) A formal (say) three month consultation on changes to key terms that affect third party retailers, with publication on the ATOC website of the results of the consultation. This would, in effect, formalise part of the informal consultation that already takes place and which we have described in earlier submissions and re-emphasised above.

We would anticipate that the formal consultation exercise would be conducted in addition to the informal consultation and negotiation that currently occurs, and which we would expect to continue.

(5) Regular review of arrangements for third party retailing by an independent body, with publication of conclusions and recommendations. We would be happy with any sufficiently independent and credible body undertaking this role.

Our own favoured approach would be a bi-annual review of arrangements by the ORR, given its role as the industry's regulator and competent authority on matters relating to consumer and competition law.

We note from the ORR's impact assessment that the ORR believes the independent review body should be able to take binding decisions. We believe that this needs more detailed consideration, particularly given the need for clarity on the criteria that the review body will use when reviewing arrangements, but also given the conclusion from the ORR's workshop on the 7th September that the review process should be relatively 'light touch'.

As far as a disputes/appeals process is concerned, we believe that the existing dispute and arbitration rights in ATOC retail licences already provide a mechanism for disputes to be raised and arbitration invoked. We would be prepared to review the existing arrangements if they were felt to be capable of improvement.

However, we believe that there needs to be clarity on how this dispute resolution process relates to the proposed independent review body and its ability to take binding decisions, as proposed by the ORR. There is a material risk of duplication in these arrangements, as well as the possibility of arrangements becoming overly-bureaucratic and costly.

In this context, it is worth highlighting that arbitration resulting from use of contractual dispute processes is generally very costly, involving extensive legal advice and the engagement of professional arbitrators, in itself a relatively costly exercise. The allocation of costs arising from the arbitration process is generally allocated by the arbitrator.

Our suggested approach is that questions relating to the general commercial framework applying to all third party retailers should be addressed through the independent review process, given that the ORR is proposing that the independent review body can take binding decisions. This should ensure that disputes relating to the overall commercial framework are dealt with by an appropriate independent body, and any resulting changes made applicable to all retailers. This would also be a significantly less costly way of dealing with such disputes.

The disputes process in ATOC licences could then be used for specific retailer disputes on issues that fell outside the general commercial framework

Overall, we believe that the package of changes described will provide considerable additional transparency to current arrangements, as well as providing greater clarity on costs and an enhanced level of engagement with third parties. We would be happy to engage with the ORR further on developing these high level proposals into more detailed arrangements, as well as agreeing an action plan for implementation.

We have also noted the ORR's concern about forward visibility on remuneration arrangements, but would note that remuneration arrangements have generally be set for defined time periods (typically 2-3 years) , providing a reasonable degree of forward visibility.

This point has been further addressed by the forward retailing strategy for third parties agreed by train companies in 2014 and now being progressively rolled out. We have described this strategy in previous submissions, but have highlighted the key points again below.

Internet retailing market (Third Party Investor Licence)

- Extend the current 5% internet and 9% telesales commission levels to 2019 and, thereafter, continue to offer it on a three year rolling basis (i.e. provide three years' notice of commission charges from 2016 onwards);

- Undertake an open book review of realised cost savings resulting from new technology by the end of 2017/18 (depending on the pace at which new technology is rolled out) with identified net cost savings being shared on an equal basis with retailers (this could potentially result in commission being reduced, if material cost savings are realised);

- Make available new technology (in particular, ticketing technology such as barcode ticketing and smartcards) to third parties where we are able to do this (noting that the stakeholders, such as the DfT, have major influence in this area); and

- Remove the £1m per year investment requirement from current and future licences

Travel Management Company (TMC) market

- Extend the current 3% commission level to 2019 and, thereafter, continue to offer it on a three year rolling basis (i.e. provide three years' notice of commission changes from 2016 onwards); and

- Make available new technology (in particular, ticketing technology such as barcode ticketing and smartcards) to third parties where we are able to do this (noting that the stakeholders, such as the DfT, have major influence in this area).

The forward strategy provides retailers with a rolling three year forward visibility on commission rates (four years in the initial period until 2019). This approach was based on proposals originally put forward by the Trainline, and is designed to provide retailers in the internet market sufficient long term visibility to allow them to invest in marketing and technology, as well as allowing TMCs to enter, in confidence, into contracts with corporate customers, which are typically three years in length.

In a commercial environment where markets and technology continue to evolve (often rapidly) this degree of industry-level forward visibility is unusual. To extend visibility beyond this would be imprudent, and place rail at a competitive disadvantage to other modes of transport.

As at the time of this submission, all internet retailers bar one had signed licences or licence variations adopting the new approach. In the TMC market, agreement with TMC representative bodies had been reached on the package (along with the addition of a 'toolkit' of possible bilateral commercial arrangements between TOCs and TMCs that had been developed and agreed by a joint TOC/ATOC and TMC working group). At the time of this submission, licence variations reflecting the new arrangements had just been sent to all licenced TMCs.

We anticipate that by the end of October 2015 all ATOC-licenced internet retailers and TMCs will have agreed formally to the new arrangements, with the possible exception of Raileasy who are still considering their position.

In terms of forward visibility of RSP costs, action is already being taken to improve the short and medium to long term visibility of RSP costs for third party retailers. The annual RSP budget, which includes off-charged costs, is a component part of the ATOC budget, which is generally only approved in February of each year, which clearly does not provide much lead time for third parties to prepare their own budgets.

Following representations from third parties, RSP is aiming to share the 2016/17 budget with third parties when it is still in its initial draft phase in early December 2015, a two month improvement on current timescales. Caveats around it being a draft will need to be made, but this RSP initiative will provide earlier information on annual costs to third parties.

In terms of the medium to longer term, third parties will be keen to understand how industry charging methods might change as central IT systems are replaced, as part of the RSP modernisation programme. Third party involvement in this programme will allow them to have early sight of new charges and allocation processes, both of which will seek to provide a fair reflection of costs and benefits.

Finally, it is worth re-highlighting the analysis contained in our last submission, which examined the possible alternatives to the current collective arrangements for third party retailing. We won't repeat all the options previously considered, as some have either been discounted or adopted as part of the proposed package of governance changes.

However, we believe that three are worth re-iterating:

(a) Remove the current collective arrangement through ATOC and allow an open market based on bilateral arrangements between TOCs and third parties;

(b) Retain the current collective arrangements for the licencing of third parties centrally, through ATOC, but remove the current collective arrangements with regard to remuneration and allow TOCs/third parties to agree commission bilaterally;

(c) Adopt a more managed approach to the market and award retail licences through competitive tender.

Option (a) would certainly remove any potential conflict of interest, but it is not clear that it would necessarily lead to a more competitive market. Under this option, third parties would have two possible approaches to licencing arrangements with TOCs. The first approach would be to be awarded a 'national retailing' licence by a specific TOC under TSA Schedule 26 arrangements. However, it seems extremely unlikely that an individual TOC or a combination of TOCs would be prepared to licence all the currently licenced third parties. Even where licences were awarded, third parties would still have the problem of finite franchise lengths and the uncertainty caused by this.

There is also a TOC issue with this approach, as potentially it could mean that one TOC could enter into licencing arrangements that had a very material impact on the businesses of other TOCs. For instance, a TOC might licence Amazon or Google, who would immediately command a significant presence in the market and materially affect the sales of all TOCs. This would be an unusual market arrangement and potentially remove TOC control over a significant element of their businesses.

Although, in principle, this risk exists at the moment it has never been realised because third parties have tended to seek licencing through ATOC, providing TOCs with a collective voice in the development of this element of the market.

The second approach would be for each third party to enter into separate licencing arrangements with each TOC for sale of that TOC's products and services. This seems even less attractive than the first option. At best it would create a very large number of licencing arrangements, all of which were still subject to the issue of finite franchise lengths.

However, a more likely outcome would be that TOCs were not prepared to individually licence many current third parties, because there would be little commercial gain to them in doing so. This would mean that many third parties would be unable to sell rail either in part or at all.

Under this option, remuneration would essentially be market-driven. As a result, it is quite possible that an airline-type business model would develop with commission generally very low or non-existent, but with greater use of specific marketing and incentive arrangements. Although these types of arrangements already exist in the rail TMC market, it is less clear how they would work in the public internet market, given current impartiality requirements.

Option (b) would address the issues of licencing associated with option (a) and would allow an open market to operate in terms of remuneration. As in (b), remuneration would be market driven. Nevertheless, it has considerable merit in terms of addressing the disadvantages associated with a non-collective approach, whilst allowing the operation of a more conventional market.

Both options (b) and (c) would, potentially, create a far more complex set of commission arrangements. RSP's initial, high level assessment is that current industry systems would not be able to support this approach. However, the two key systems concerned, Lennon and Automated Settlement, will be replaced over the next 3-4 years and their replacements could be specified to support the more complex commission arrangements, inherent in options (b) and (c). As such, this alternative market model would be possible from 2017 or 2018 onwards.

Option (c) would be to adopt a completely different approach to the market by introducing similar arrangements in the domestic market to those currently used in the international market. This could work on the basis of ATOC undertaking competitive tenders for retailing partners every, say three or five years. This would be an open, transparent process which allowed competition between retailers and allowed TOCs/ATOC to choose, high-quality retailing partners more selectively. It is an approach that has worked well in the international market, as well as for the online sale of Railcards.

However, there are clearly issues with this option in terms of the number of retailing partners that might be appointed, commission arrangements in the context of competitive tenders and so on. There would also be very significant transitional issues in moving from current arrangements to this alternative model.

Insofar as perceived conflicts of interest are a concern then these three options need to be borne in mind, as they effectively form alternatives to the governance changes previously considered. Option (b) in particular is a potentially viable market model.

We ought to conclude that whilst we have not discussed any of these options with third party retailers in any detail, informal discussion with a few retailers over time on options (a) and (b) has consistently found a fairly negative attitude towards these alternatives.

6.3 Question 7: What are your views around the industry could reduce the barriers smaller retailers face in selling rail tickets?

We are supportive of initiatives that would potentially encourage smaller retailers to enter the market and increase the market for rail (noting that a number of ATOC-licenced retailers are relatively small, and that train companies have also individually licenced a number of small retailers, particularly on stations).

In this context, we would be happy to see impartiality requirements relaxed and smaller retailers allowed to sell a much more limited range of fares (indeed we would be happy with the principle more generally, provided that there was clear information provided to consumers on the range of tickets sold, and not sold through a specific retailer).

As far as the cost of TIS is concerned, this is much more an issue for TIS suppliers. We do not believe that accreditation places an unreasonable burden on TIS suppliers, but would nevertheless be open to ways of reducing accreditation costs if lower specification machines were developed for the small retailer market. Machine leasing is an interesting idea, of which we would be supportive, but is clearly something for TIS suppliers to develop and offer.

It is also worth noting that the industry's emerging future ticketing strategy, which is based around a move from paper to digital ticketing ought to reduce costs for all retailers, including smaller retailers by removing the need to procure and operate physical ticket printers.

Whilst generally supportive of initiatives to encourage smaller retailers to enter the market, we should emphasise that such arrangements need to work from a commercial perspective for train companies and retailers. In particular, remuneration needs to be agreed at a level that provides an adequate return for retailers, whilst not reducing the profitability of train companies or driving the need for additional taxpayer support. Crucial to this, as the ORR's impact assessment correctly identifies, is the extent to which new retailers drive additional revenue that exceeds additional costs.

It is worth noting that ATOC on behalf of TOCs is already discussing possible market entry by potential retailers in this section of the market, and we have briefed the ORR in confidence on these discussions. We also continue to evaluate the possibility of a new form of licence (or, at least, specific commercial terms) for the small retailer market.

We would be happy to work with other stakeholders in further evaluating possible opportunities in this market.

6.4 Question 8: What are your views around our emerging findings that there could be increased scope for third party retailers to compete in selling tickets? Specifically, what are your views that all retailers should have access to all fares and products? What are your views on retailers' ability to discount fares, and to what extent should retailers have access to these discounted products (at the cheaper price)? What are your views around third party retailers' inability to create new fares and products, and do you consider further consideration could be given to options that provide for a net pricing or something similar)?

Access to all fares and products – ATOC licences

In terms of ATOC licences, we are puzzled by the emerging conclusion that third parties are prevented from selling the full range of rail products.

The only material example of this is the current preclusion of Season Ticket sales. However, as the consultation document makes clear, the extension of Season Ticket retailing to third parties is currently the subject of an industry trial involving the Trainline, Evolvi and a number of Evolvi's TMC customers. Subject to the successful conclusion of this trial in mid-2016, Season Ticket retailing will be extended to all third parties.

Beyond this, we made very clear in our last submission that third party retailers (TMCs, TPIL and ISL holders) are allowed by their licences to sell all fares included in the RSP fares feed, with a very limited number of exclusions:

- Tickets purchased with the benefit of a railways staff 'privilege' card;
- Disabled Person's Railcard and HM Forces Railcard;
- Eurostar interlining fares (may be sold by agreement with ATOC and Eurostar);
- ITX fares.

As previously emphasised, these excluded products are not material in value. In 2014/15 total sales were £21m, representing just 0.2% of total industry revenue.

Furthermore, there are specific reasons why each of these products is excluded. Staff ‘privilege’ tickets require the purchaser to be in possession of the relevant staff identity card and discount card at time of purchase, and the rules of use mean that single and return tickets can only be used for leisure travel. Given these restrictions, privilege tickets can only currently be purchased from station ticket offices.

Disabled Persons Railcards (‘DPRCs’) also require evidence to be submitted prior to purchase, proving that the applicant meets at least one of the required criteria for purchase of the card. As a result of the additional complexity involved in selling DPRCs, ATOC has opted to sell through a single third party retailer appointed through an open, competitive tendering process, rather than through an ATOC licence. This contract will be re-tendered in 2016 and any third party retailer will be able bid for the contract.

We also believe that having a single retailer works better from the perspective of customers with a disability.

HM Forces Railcards (‘HMFRCs’) are offered to active service personnel on a voluntary basis by train companies in what is, in effect, an industry-level corporate and social responsibility initiative. HMFRCs are not retailed in a conventional sense, and the HMFRC scheme is entirely administered (including the issue of Railcards and taking of payment) by the Ministry of Defence, largely for security reasons, given the need for access to personal data for Forces personnel.

As far as Eurostar interlining fares are concerned, we are not able to provide sole permission to sell these fares as they are a joint product, and retailers also require the permission of Eurostar. In principle, we have no objection to third parties retailing these fares.

Finally, ITX fares can only be sold by the holders of ITX licence holders, which any third party is entitled to apply for.

We would be extremely surprised if any third party had left the market as a result of these exclusions and would be interested to see any evidence that the ORR has to support its conclusion.

Access to all fares and products – TOC exclusive discounts and products

TOC specific discounts and products are a more complex area, and the ORR’s consultation document usefully summarises the arguments for and against such products and discounts.

However, from an ATOC perspective, this is not an area where any collective, industry-level policy has been agreed. Each train company sets and implements its own strategy in this area, and, as a result, there are some fairly significant differences in the approaches adopted by train companies.

As such, and in the absence of a collective view on this issue it would be inappropriate for ATOC/RDG to comment. Instead train companies will comment on this question in their individual responses.

Net fares

The idea of a wholesale market in rail fares is an interesting one, although it needs a good deal further consideration. We have highlighted below, some of the issues we believe to be worth considering:

(1) There would be a clear risk that the customer perception that rail fares are overly complex could be significantly exacerbated (noting that prices could vary by channel and by retailer within that channel);

(2) The appropriate level for base prices needs to considered, given the difficulty in disaggregating industry costs to the level of an individual customer journey or ticket (as the consultation document correctly points out short run marginal costs are very low);

(3) Mark-ups also have the potential to be contentious with the possibility that third parties would complain that train company mark-ups were below cost, and with train companies likely to argue that this would in their commercial interests as they have a very strong interest, as carriers (as well as retailers) in 'owning' the relationship with customers.

One third party has suggested that to avoid this, train companies could be obliged to charge a regulated minimum mark-up (5% was suggested). However, this is likely to lead to complaints of unfair competition from train companies if they were undercut by third parties and unable to respond.

(4) Net pricing is fundamentally incompatible with the current regulatory obligation with regard to impartiality. As such regulation would need to be changed, and it is possible that price comparison websites would develop for the rail market. It is an open question as to whether this would, on balance, benefit customers.

(5) Based on the experience of net pricing in Sweden, where the consultation document highlights that retail margins have ended up at similar levels across all retailers, there has to be some question as to whether net pricing really would engender greater competition in the market.

It is also worth noting that there may be implications for industry and retailer systems although we haven't evaluated this.

Overall, we are somewhat sceptical about whether net pricing offers material benefits, but would be happy to consider the option in more detail. A good starting point would be to examine the Swedish market in more detail. ATOC's own, anecdotal feedback is that the experience has been mixed at best. It is also worth noting that Swedish rail retailing market is completely unregulated, as we understand it.

It is also worth noting that net fares are already offered to package tour operators through the current ITX licence and ITX fares.

7 Responses to questions posed in the ORR's consultation document – responses to the questions in chapter 5

7.1 General comments on chapter

We do not have any general comments on this chapter. We have responded to the ORR's specific questions below.

7.2 Question 9: Do you agree with our emerging findings that TOCs have limited incentives to collaborate with each other in the development of shared systems? To what extent do you consider that having an increased emphasis through innovation funding mechanisms of the role of an integrated national network (and this the role of shared IT systems) could address the issues? To what extent do you consider that a strategy, led by government with input from across industry, on future ticketing can play a role?

Limited TOC incentives to collaborate

We do not agree that TOCs have limited incentives to collaborate with each other in the development of shared systems, and do not believe that the evidence supports this conclusion.

The regulatory framework created at privatisation effectively created obligations with regard to some shared systems, in particular fares and settlement. However, train companies have chosen to go much further than these obligations through creation of a range of central industry IT systems. Some of the key systems have been summarised below:

- The current National Reservation System (NRS), which was the subject of a major procurement in 2002 and has cost TOCs in the region of £90m over its lifetime to date;
- The Central Transaction Record database, which was created to support ToD;
- The introduction of the Lennon system to replace CAPRI which has cost TOCs approximately £100m over its lifetime to date;
- The Automated Settlement Service, which was introduced in 2007/08 to modernise rail settlement and will have cost TOCs in the region of £50m over its lifetime by the time it's replaced;
- The National Rail Enquiries website and associated journey planning and fares functionality;
- The National Rail Enquiries App;

- Darwin real time travel information;
- The Passenger Assist booking system for travellers with disabilities.

The full suite of RSP central IT systems is currently the subject of a wholesale modernisation programme, which began with the replacement of the ToD Database with the Live Sales Management (LSM) Service in 2014, and will continue until 2017/18, by which time RSP will also have replaced Lennon, Automated Settlement and NRS. This modernisation programme is being undertaken entirely at the initiative of the TOC community through RSP, and would not be possible without collaboration between and funding from TOCs.

In addition, RSP is undertaking procurement of a new smartcard back office (an ITSO 'HOPS') that will extend its range of settlement capabilities. Work is also continuing on preparation for a new central validation system for Railcards. There has also been an increasing move towards TIS upgrades being centrally procured through ATOC/RSP rather than by individual train companies.

Train companies have chosen to continue to procure systems collectively because it is generally more cost effective to do this than procure such systems individually, but also because the interoperable nature of the industry drives such a centralised approach. For instance, it is difficult to see how there could be anything other than a central fares database given fare setting, regulatory compliance, customer information and retailing requirements.

Train companies have been highly innovative in the ways that they have developed commercial frameworks to support the development of central systems. Typically systems have been financed using low-cost commercial loans, negotiated by RSP. System costs have then been amortised and recovered through charges levied over the full life of the system or through usage charges. The latter in particular has been effective in linking cost with benefit.

This approach has effectively addressed issues associated with finite franchise lengths, train companies nearing the end of their franchise, and differing levels of TOC benefit from specific systems.

Given the complexity of these systems, we would challenge the assertion in the consultation document that they have taken longer to procure and develop than should have been the case. We have previously suggested the ORR benchmark rail industry procurement of central systems against comparable multi-user, complex-system procurements, and still believe that this would be a worthwhile exercise.

It is clearly correct that developing a train company consensus on the need, scope and specification for new systems takes time, but we do not believe that this creates significant delay, and is similar to the sorts of lead time associated with any complex, multi-user system.

We would also note that greater third party involvement in system specification, over and above that described in our answer to Q10 below, is likely to elongate timescales.

Increased emphasis on innovation funding mechanisms

Innovation funding is a welcome development of recent years. However, we would make a number of points with regard to its use in relation to central industry systems:

- Innovation funding is generally targeted at areas where the market of its own volition is unlikely to develop solutions. As set out in the previous section, we do not believe that there is evidence of significant market failure as far as central systems are concerned.
- There are now a number of innovation schemes including Future Rail (TOC15 and others), Transport Systems Catapult, franchise innovation funds and the European-level Shift2Rail, and there is a need for better co-ordination between these initiatives;
- The processes by which funding is actually released are insufficiently transparent and themselves lead to confusion and wasted effort;
- There is insufficient involvement of the supply chain – TIS suppliers for instance – in schemes.

Whilst innovation funding has an important role to play, we believe that it is better targeted towards leading-edge technology projects; in particular where it can provide a stimulus to the market (future ticketing based on iris or fingerprint recognition for instance). As such it is complementary to rather than a replacement for current approaches to industry collaboration with regard to central systems.

However, we do believe that there is a role for greater government involvement through HLOS and, specifically the provision of government funding, through grants, for investment in customer experience initiatives.

By contrast, grant funding in Control Period 5 ('CP5') is almost exclusively focused on operational infrastructure. In this context, we will be making a strong case for 1% of government grant funding in CP6 to be spent on specific investments in customer experience initiatives.

National ticketing strategy

As previously highlighted, we are extremely surprised that the consultation document does not make reference to the significant RDG-led initiative to develop a national ticketing strategy.

The initiative emerged from the 2013 DfT Fares and Ticketing Review, where ATOC strongly advocated development of a national ticketing strategy to increase the pace of change outside London. Following endorsement by then Transport Minister Stephen Hammond in 2014, a joint RDG-DfT steering group was established, which also included representation from TfL and the PTEs.

Following two multi-stakeholder workshops, a putative strategy has been developed, and has been the subject of widespread consultation with stakeholders. The strategy is now being developed in more detail, and work on a supporting business case and delivery road map has now begun.

It is planned to seek Ministerial support for the strategy, which is based on smartcard/CPAY PAYG schemes in urban areas and m-ticketing across the rest of the network, by the end of the year.

The work on developing a national ticketing strategy has progressed well over the last twelve months, and would seem to be just the kind of collaborative, industry-led project that this question suggests there should be more of. There is widespread agreement that it sets out an achievable vision for the industry that will allow a progressive, but relatively fast-paced migration from magnetic stripe ticketing to digital ticketing.

RDG has deliberately adopted a multi-stakeholder approach to the project, given the need for broad support if inter-operability is to be maintained and the opportunities for multi-modal ticketing exploited in the conurbations.

This has proved to be an effective approach, and we would strongly advocate that it continues to be the model employed for the development and roll-out of future ticketing. We do not support a purely government-led approach to this work.

More generally, we believe that the model developed for future ticketing has potentially wider application,

7.3 Question 10: What are your views, as a possible longer-term option, to consider relaxing the obligations on TOCs to facilitate a fully integrated national network?

The regulatory framework is general is wide-ranging, encompassing price capping, measures to support an integrated network, as well as obligations that seem to have little purpose other than preserving some elements of the pre-privatised railway.

Price capping, in those commuter markets where rail has a dominant market share, has a clear economic rationale, and we have previously made clear our support for its retention (although it may need to evolve in line with new approaches to fares and ticketing). However, beyond this we have argued for some considerable time that the rest of the regulatory framework should be reviewed, including those elements that support an integrated national network.

As we have emphasised in previous submissions the current market is a mixture of competition, collaboration and regulation; a mixture which has evolved over time, rather than being created by design. The starting point for any regulatory review, therefore, needs to be consideration of the kind of market model that would work best for customers, operators and taxpayers. Any review of the regulatory framework should then be focused on re-designing the framework to work within and, where necessary, to support the desired model.

If a truly holistic approach is to be adopted, and we would advocate that it should be, initial consideration of the desired market model should also include the role of franchising policy, given its fundamental importance to the operation of the market.

Although we have no fixed views on the outcome of the suggested review, it seems likely that it could lead to the relaxation, removal or adaption of some but not all current regulatory obligations, and the move to an output based approach to those that remain. We certainly have an extensive list of ideas and challenges that we would like to contribute to the suggested review.

Overall, we strongly agree that the regulatory framework that supports a fully integrated national network should be reviewed, as part of a wider review of regulation. We would add that such a review should be conducted relatively quickly and ideally be industry-led, notwithstanding that government would clearly be ultimately responsible for taking decisions on changes to regulation.

One final point is that we are somewhat sceptical that relaxation of the obligations to facilitate a fully integrated national network would allow retailers to develop their own systems, given the current procurement and interoperability benefits that are associated with central industry systems.

7.4 Question 11: What are your views on the role of third parties (including third party retailers, passenger representatives and technology providers) in the development of shared IT systems? To what extent could formal working groups address the issue?

In general, we welcome third party involvement in the development of shared industry systems, but there is clearly an appropriate balance that needs to be struck between the potential benefits that derive from meaningful involvement and the potential downsides associated with more complex governance arrangements, such as extended timescales and higher costs. It also needs to be remembered that central systems support train companies as carriers in their operation of the National Rail network, as well as the retailing market.

In this context, we should highlight that RSP already involves third parties in defining requirements for key shared industry IT systems. For example, the current Reservations Replacement project (due to go live in 2017/18) has included the involvement of three key third party retailers in defining and reviewing the requirements for the retail work stream.

RSP has also previously consulted with third parties and ticket machine suppliers through workshops, as part of the Fares Replacement project (due to go live in 2016), and has shared specifications which describe, for example, the variations between the legacy data feeds and those to be delivered by the new service.

Generally speaking the governance arrangements for the procurement of shared industry IT projects are through Programme Boards, specific Project Boards and user/special interest groups. Involvement of third parties through user/special interest groups is an approach that has worked well, and which RSP expects to use going forward. RSP is already planning to do this for the Reservations Replacement project, focussed on the areas where third parties have most interest, such as the retailing and technical work streams.

With regard to the Lennon Replacement project (due to go live in 2018), third party retailers and TIS suppliers have been invited to technical workshops to obtain their feedback on improvements to the sales data capture interface and the test service used for accrediting ticket issuing systems. One-to-one meetings were also held with each retailer to discuss initial thoughts on connectivity to the replacement system. Third party retailers will also be involved in user workshops during the design phase of the project, mainly in relation to sales data capture interfaces and connectivity.

RSP will also be asking third party retailers to participate in Lennon Replacement user acceptance testing, and may itself become involved in any additional informal pre-testing undertaken by suppliers. Once the project moves to the implementation phase, third party retailers will be invited to join an Implementation Working Group (as they did for the implementation of the Live Sales Management Service which went live in 2014) to discuss and agree the actions required to implement the new system.

We believe that RSP already appropriately involves third party retailers in the development of central IT systems, as demonstrated above, with a view to ensuring that the delivered systems are the best for the wider industry rather than just train companies.

However, as we have already highlighted, the right level of involvement is a matter of balance, and, therefore, necessarily an element of judgement, and we would be open to specific ideas for change or improvement, where there are strong supporting arguments.