Department for Transport

Dan Moore
Deputy Director
Rail Delivery Strategy
Department for Transport
DIRECT LINE: 020 7944 3638

Web Site: www.dft.gov.uk

19 February 2016

John Larkinson
Director, Economic Regulation and Consumers
Office of Rail and Road
1 Kemble Street
London
WC2B 4AN

Dear John

Thank you for your letter of 29 January 2016, setting out your queries on our earlier letter regarding the ECML Connectivity Fund.

I am afraid that it is impossible for us to answer some of the questions you pose at this time, as until the ORR has reached decisions regarding access rights on the route, the spectrum of possibilities is too wide for us to construct plausible counterfactuals regarding the business cases of either specific schemes or the Fund as a whole.

However, in respect of your first question, we can confirm that our intent was to convey that the case for the Fund itself, rather than specific projects which may have been delivered through it, may need to be revisited in the event of open access applications being granted. Until we are aware of the specific package of access rights awarded on the ECML, we are not in a position to say what the outcome of such a reconsideration might be.

In respect of your second question, there was not, at the time of the HLOS, a specific appraisal made of the business case for any specific schemes. Rather, there was an agreement that Network Rail would be responsible for the governance of the Fund and that there would be a BCR threshold of 1.5 for individual projects. The decision to promote the Fund itself, however, was intended to support the delivery of the IEP business case, which required 6 franchised paths per hour, and was predicated upon the assumption that the East Coast franchise let by the Department would not be subject to further abstraction of revenue by open access operators, above and beyond those which already operate on the route.

In respect of your third question, in general, the Department would assess the business case for any investment decision in line with the guidance in the Green Book and WebTAG, in particular with reference to the BCR (where the ‘C’ represents the net costs to Government, taking into account both capital cost and the future impacts on operating costs and revenue, such as changes to franchise payments). Compared to a base scenario in which incremental capacity was used by the franchised operator, allocating this capacity to an Open Access operator would have the effect of increasing these net costs, because the Department's revenue from franchise premia and Network Rail's revenue from access charges would be reduced compared to the base case scenario. In financial terms it is almost certain that the Government would be better off if the fund was not spent at all, rather than used to provide capacity for Open Access operators to abstract revenue from the franchise.

Therefore, a decision to allocate the capacity to an Open Access operator would be highly likely to have a negative impact on the business case for the Fund, and in particular would reduce the BCR, perhaps substantially, and quite conceivably (depending on the nature of any decision made by the ORR to grant access rights to an open access operator) to less than 1.5. We would, however, undertake any such assessment once the ORR had made its decision, at which point we will have more visibility of any likely impacts of that decision.

We would also highlight that we would undertake any new economic appraisal in line with standard WebTAG principles, and therefore the economic appraisal undertaken by CH2M for ORR should not be considered indicative of the results that such an appraisal would show.

The considerations set out above in response to your first three questions also mean that we are not, at this point, in a place to provide answers to your remaining questions. However, we should emphasise that in any scenario, taking into account the assumptions for the Fund set out above, an abstraction of revenue will necessarily have a detrimental impact on the business case.

DfT would therefore encourage the ORR to consider this issue with reference to the ORR's statutory duties in making its decision.

Yours Sincerely

Dan Moore

Dan Moore
Deputy Director, Rail Delivery Strategy